99th Congress
1st Session

COMMITTEE PRINT

S. Prt.
99-18

SMALL BUSINESS ISSUES AND PRIORITIES—1985

BY STAFF MEMBERS OF THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

WITH

REPRESENTATIVES

OF

SMALL BUSINESS ORGANIZATIONS

FEBRUARY 6, 1985

Printed for the use of the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE
44-110 O WASHINGTON : 1985

S722-2

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SENATE SMALL BUSINESS COMMITTEE ASSOCIATION MEETING

FEBRUARY 6, 1985
ROOM 428A SR
9:30 a.m.

MORNING SESSION

PANEL I

MR. TOM CATOR
Legislative Counsel
Small Business United
Washington, D. C.

MR. HERBERT LIEBENSON
President
National Small Business Association
Washington, D. C.

MR. JOHN MOTLEY
Director of Federal Legislation
National Federation of Independent Business
Washington, D. C.

PANEL II

MR. FRANK CARROLL
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MR. ROGER S. VAIL
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MR. MARTIN ORR
President
National Association of Development Companies
Washington, D. C.

MR. DAVID KELLY
President
National Association of Metal Finishers
Seattle, Washington

MS. FRANCES SHAINE
Accompanied by: Tom Donnelly
Board of Directors
U.S. Chamber of Commerce
Washington, D. C.

PANEL IV

MS. HOPE EASTMAN
Director of Public Affairs
National Association of Women
Business Owners
Chicago, Illinois

MR. WALTER GALANTY
Executive Director
National Association of Brick Distributors
Alexandria, Virginia

MR. JOHN SATAGAJ
Director of Governmental Affairs
American Association of Nurserymen, Inc.
Washington, D. C.

PANEL V

MR. DEWEY THOMAS
Executive Director
National Association of Minority Contractors
Washington, D. C.

MR. STEVEN DENLINGER
President
Latin American Manufacturers Association
Washington, D. C.

PANEL VI

MR. PATRICK BURNS
Chairman
American Association of Minority Enterprise
Small Business Investment Companies
Washington, D. C.

STEVEN JUNG, Esquire
Counsel
Automotive Warehouse Distributors Assoc.
Washington, D. C.

MR. BEN COOPER
Senior Vice President
Government Affairs
Printing Industries of America, Inc.
Arlington, Virginia

RECONVENE AT 2:00 p.m.

AFTERNOON SESSION

PANEL I

MR. JOSEPH O'NEIL
Executive Director
American Council of Independent Laboratories
Washington, D. C.

MR. ROBERT GRILLE
President
National Society of Public Accountants
Alexandria, Virginia

PANEL II

MR. LONNIE HOLLINGSWORTH
Chairman of the Executive Board
National Association of Retail Druggists
Alexandria, Virginia

MR. KENTON PATTIE
Senior Staff Vice President
International Communications Industries Association
Fairfax, Virginia

MR. WILLIAM BIRKHOFFER
Managing Director - Governmental and
International Services
American Consulting Engineers Council
Washington, D. C.

PANEL III

MR. JAY MORRIS
Washington Weekly Editor
National Restaurant Association
Washington, D. C.

MR. DENNIS LAVALLEE
Director of Governmental Affairs
National Association of Plumbing, Heating &
Cooling Contractors
Falls Church, Virginia

MS. VIRGINIA LITTLEJOHN
President
Professional Services Council
Washington, D. C.

PANEL IV

MR. NEIL GRAY
Director of Governmental Affairs
National Asphalt Pavement Association
Riverdale, Maryland

MR. LARRY BRAZELL
Brazell Electric
West Hartford, Connecticut
    Independent Electrical Contractors, Inc.
    Washington, D. C.

MR. RICHARD TROLL
Executive Director
Association of Independent Corrugated Converters
Alexandria, Virginia

PANEL V

MR. DONALD RAPPAPORT
National Director of Smaller Business Services
Price Waterhouse
Washington, D. C.

MR. ROBERT P. WYNN
MR. WADE WILLIAMS
Deloitte-Haskins and Sells
Washington, D. C.

MR. HERB SPIRA
Tax Manager, Small Business Liaison
Arthur Andersen & Co.
Washington, D. C.

CONTENTS

Statement of Senator:

Page
Weicker, Hon Lowell, Jr., a U.S. Senator from the State of Connecticut, and chairman, Senate Small Business Committee 1

Statement of:

American Subcontractors Association, Arlington, VA 319
Bashwiner, Lydia Barbara, Esq., executive director, National Small Business Government Contractors Association, Fairfield, NJ 342
Bennison, John C., staff vice president, government affairs, American Society of Travel Agents, Inc., Washington, DC 348
Birkhoffer, William J., managing director, governmental and international services, American Consulting Engineers Council, Washington, DC 219
Brazell, Larry, Brazell Electric, West Hartford, CT, Independent Electrical Contractors, Inc., Washington, DC 280
Burns, Patrick Owen, chairman, American Association of Minority Enterprise Small Business Investment Companies, Washington, DC 166
Carroll, Francis R., president, Small Business Service Bureau, Inc., Worcester, MA 29
Cator, Tom, legislative counsel, Small Business United, Washington, DC 3
Cooper, Benjamin Y., senior vice president, government affairs, Printing Industries of America, Inc., Arlington, VA 179
Denlinger, Stephen, president, Latin American Manufacturers Association, Washington, DC 156
Eastman, Hope, director of public affairs, National Association of Women Business Owners, Chicago, IL 81
Farruggia, Sal, legislative committee chairman, National Association of Plumbing-Heating-Cooling Contractors, Falls Church, VA 237
Galanty, Walter E., Jr., chairman, Small Business Legislative Council, Washington, DC 109
Gleason, John P., Jr., president, Brick Institute of America, Reston, VA 358
Gray, Neil, director of government relations, National Asphalt Pavement Association, Riverdale, MD 272
Grille, Robert, president, National Society of Public Accountants, Alexandria, VA 192
Hackett, Stanley H., attorney at law, Troutman, Sanders, Lockerman & Ashmore, Atlanta, GA 510
Hardman, William E., National Tooling & Machining Association, Washington, DC 366
Harper, Bruce J., chairman, Committee on Small Business, American Institute of Certified Public Accountants, Washington, DC 373
Hollingsworth, Lonnie F., P.D., chairman, executive committee, National Association of Retail Druggists, Alexandria, VA 207
Independent Bankers Association of America, Washington, DC 375
Jung, Steven A., counsel, Automotive Warehouse Distributors Association, Washington, DC 173
Kelly, David G., president, National Association of Metal Finishers, Seattle, WA 62
Kidd, Yvonne, executive director, Coalition for Common Sense in Government Procurement, Washington, DC 385
Liebenson, Herbert, president, National Small Business Association, Washington, DC 8
Littlejohn, Virginia, executive director, Professional Services Council, Washington, DC 259
MacArthur, Malcolm D., general counsel, Specialty Advertising Association International, Keller & Heckman, Washington, DC 389
Machinery Dealers National Association, Washington, DC 486

Page

Statement of—Continued

Morris, Jay, manager of government research and publications, National Restaurant Association, Washington, DC 233

Motley, John, director of Federal legislation, National Federation of Independent Business, Washington, DC 16

Muehleib, William, chairman, executive committee, Coalition for Multiple Award Contracts, Alexandria, VA 393

National Association of Manufacturers, Washington, DC 396

National Federation of Business and Professional Women's Clubs, Inc. (BPW/USA), Washington, DC 414

National Machine Tool Builders' Association, Washington, DC 441

O'Neil, Joseph F., executive director, American Council of Independent Laboratories, Inc., Washington, DC 184

Orr, J. Martin, president, National Association of Development Companies, Washington, DC 57

Pattie, Kenton, senior staff vice president, International Communications Industries Association, Fairfax, VA 216

Rappaport, Donald, national director of smaller business services, Price Waterhouse, Washington, DC 296

Santy, Robert W., director, Small Business Affairs, Touche Ross & Co., Washington, DC 469

Satagaj, John S., director of governmental affairs, American Association of Nurserymen, Inc., Washington, DC 135

Shaine, Frances, accompanied by Tom Donnelly, board of directors, U.S. Chamber of Commerce, Washington, DC 68

Spira, Herbert L., small business liaison, Office of Federal Tax Services, Arthur Andersen & Co., Washington, DC 308

Staats, Elmer B., chairman, Procurement Round Table, Arlington, VA 457

Stults, Walter B., president, National Association of Small Business Investment Companies, Washington, DC 50

Thomas, Dewey, Jr., executive director, National Association of Minority Contractors, Washington, DC 145

Troll, J. Richard, executive director, Association of Independent Corrugated Converters, Alexandria, VA 292

Vail, Roger S., chairman of the board of directors of the independent stores division, National Retail Merchants Association, Washington, DC 44

Zegar, Denis R., vice president, government services, National-American Wholesale Grocers' Association, Falls Church, VA 460

MEETING DATE

February 6, 1985 1

OPENING STATEMENT OF SENATOR LOWELL WEICKER, JR.

AT THE

ASSOCIATIONS MEETING

FEBRUARY 6, 1985

I WOULD LIKE TO BEGIN THIS MORNING BY THANKING YOU FOR YOUR WILLINGNESS TO PARTICIPATE IN THIS MEETING, THEREBY ASSISTING THE SMALL BUSINESS COMMITTEE CHART ITS LEGISLATIVE COURSE FOR THE 99TH CONGRESS.

IT IS MY BELIEF THAT THE COMMITTEE'S PRIORITIES SHOULD REFLECT, WHEREVER POSSIBLE, THE VIEWS AND PROGRAMMATIC NEEDS OF THE SMALL BUSINESS COMMUNITY. THE STATEMENTS YOU DELIVER TODAY AND THE DISCUSSIONS WE ENTER INTO WILL SERVE TWO IMPORTANT PURPOSES: FIRST, THEY WILL PROVIDE INVALUABLE GUIDANCE TO MYSELF, SENATOR BUMPERS, OTHER COMMITTEE MEMBERS, AND STAFF AS WE ESTABLISH OUR SMALL BUSINESS AGENDA, AND, FURTHER, YOUR COMMENTS WILL BECOME PART OF A COMMITTEE DOCUMENT WHICH HAS IN PAST YEARS PROVEN TO BE AN IMPORTANT REFERENCE TOOL FOR ANYONE INTERESTED IN KNOWING AT A GLANCE WHAT CONCERNS THE LEADERS OF AMERICAN SMALL BUSINESS.

YOU SHOULD ALL BE AWARE THAT THE LEAD-OFF ITEM AND HIGHEST PRIORITY FOR COMMITTEE CONSIDERATION THIS SESSION WILL BE THE ADOPTION OF A NEW BUDGET FOR THE SMALL BUSINESS ADMINISTRATION. SENATOR BUMPERS AND I WILL INTRODUCE LEGISLATION TO AUTHORIZE

FUNDING FOR THE SBA'S PROGRAMS AND ACTIVITIES FOR THE NEXT THREE FISCAL YEARS. THE BILL, IF ENACTED, WILL RESULT IN SIGNIFICANT SAVINGS WITHIN THE AGENCY THROUGH BUDGET FREEZES AND CERTAIN PROGRAM ELIMINATIONS. THE LEGISLATION EXPRESSES OUR FIRM INTENTION THAT THE SBA CONTINUE TO PROVIDE TECHNICAL AND FINANCIAL ASSISTANCE TO SMALL BUSINESSES ACROSS THE COUNTRY.

I DEEPLY APPRECIATE THE TIME YOU HAVE TAKEN TO TESTIFY BEFORE THE COMMITTEE TODAY. I LOOK FORWARD TO WORKING WITH YOU ALL AS WE ATTEMPT TO IMPROVE AND ENHANCE ONE OF OUR NATION'S GREAT ECONOMIC RESOURCES: ITS SMALL BUSINESS SECTOR.

Mr. Chairman:

My name is Tom Cator. I am Legislative Counsel for Small Business United (SBU), a national coalition of sixteen regional, state and metropolitan trade associations representing 70,000 businesses.

Attached to my statement is the list of SBU's top ten legislative and administration priorities for 1985. Today I would like to briefly discuss the top five priorities.

Our top priority, two priorities with equal emphasis, are saving the Small Business Adminstration (SBA) as an independent agency within the federal government; and, an across-the-board agency-by-agency two year freeze on federal spending.

First, with respect to SBA, we adamantly oppose the administration's proposal to abolish the agency and transfer many of its functions to the Commerce Department. Although this propsal is made under the cloak of budget reductions,it has nothing to do with reducing the deficit. In fact, we believe it will increase the deficit by $7.3 billion over the life of SBA's loan portfolio. Additionally, we believe much of the rationale supporting the administration's proposal is specious. For example, since when are Healthdyne, Federal Express, Nike Shoes, or Air Midwest economic strap hangers as OMB suggests they are. Finally, the administration's proposal is entirely inconsistent with actions it took only a year ago to increase the funding levels for the 7(a) and 503 loan programs and to improve the secondary market for 7(a) loans through the signing of the Secondary Market Improvement Act.

Perhaps most imporantly, the proposal fails to take two points into consideration. Without SBA, there is no need to have two standing Congressional Small Business Committees. From our perspective, without those Committees, the SBIR program, the Late Payments Act, procurement reform, the White House Conference legislation and many other bills of concern to small business never would have come into being.

Second, it ignores the good job Jim Sanders has done in revitalizing the agency and in relying to a greater degree on the private sector to deliver SBA assistance.

We strongly urge you and the other Committee members to oppose the administration's proposal.

With respect to reducing the federal deficits, SBU supports a two year freeze on federal spending, including the SBA, and urges Congress to adopt a two year, rather than a one year, budget cycle. Additionally, we believe Congress and the administration should implement many of the Grace Commission recommendations. Although the Commission may have overstated the budget savings to be derived from implementing its recommendations, those recommendations still have merit. Small business is one area of the economy hit hardest by the high interest rates resulting from continued, excessive federal spending. It is an issue commanding your immediate attention.

Our second priority is tax reform. There are a myriad of proposals being suggested in the name of such reform. Like most other organizations and people, we want reform but we have not yet seen a proposal we are ready to embrace. We continue to support graduated corporate income tax rates and believe any reform proposal must address the issue of ever spiraling payroll taxes.

SBU's third priority is the reauthorization of the Equal Access to Justice Act. We were dismayed bv the President's veto of this bill last year. We understand Senator Grassley will reintroduce the same bill or a smaller bill this year. We strongly urge every member of the Committee to cosponsor it.

Mr. Chairman, in the past several Congresses, you have introduced bills authorizing the creation of Small Business Participating Debentures. SBU has always endorsed those bills. We urge you to again introduce this legislation and hope you will be able to secure cosponsorship of it from Finance Committee members.

The last issue I wish to discuss is enactment of a uniform federal product liability bill. Senator Kasten has again introduced a bill, S. 100, accomplishing this goal. It is a bill which deserves your support and we urge you and the other members of the Committee to cosponsor it.

Mr. Chairman, we thank you for the opportunity to discuss our issues with you. We hope the 99th Congress will take favorable action on them.

SMALL BUSINESS UNITED'S 1985
LEGISLATIVE AND ADMINISTRATIVE PRIORTIES

1. SAVE SBA (TIE)

   REDUCE DEFICITS: (1) AGREE TO A 2-YEAR FREEZE; (2) ADOPT A 2-YEAR BUDGET CYCLE; AND (3) IMPLEMENT GRACE COMMISSION RECOMMENDATIONS (TIE)

2. TAX REFORM/PAYROLL TAXES/CORP. TAX RATES

3. REAUTHORIZE EQUAL ACCESS TO JUSTICE ACT AND REDUCE REGULATIONS AND PAPERWORK

4. AUTHORIZE SMALL BUSINESS PARTICIPATING DEBENTURES

5. ENACT FEDERAL PRODUCT LIABILITY LAW

6. GOVERNMENT COMPETITION/GOVERNMENT PROCUREMENT

7. MAINTAIN CURRENT LAWS GOVERNING THE USE OF INDUSTRIAL REVENUE BONDS

8. SMALL BUSINESS REPRESENTATION

9. INTEGRATED TAX SYSTEM

10. BANK EQUITY INVESTMENT

"The Voice of Small Business"

National Small Business Association
Founded 1937

STATEMENT OF

HERBERT LIEBENSON

OF THE

NATIONAL SMALL BUSINESS ASSOCIATION

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

HOLDING HEARINGS

TO RECEIVE RECOMMENDATIONS OF SMALL BUSINESS GROUPS

REGARDING THE COMMITTEE'S AGENDA FOR THE 99TH CONGRESS

FEBRUARY 6, 1985

STATEMENT OF HERBERT LIEBENSON OF THE NATIONAL SMALL BUSINESS ASSOCIATION BEFORE THE SENATE SMALL BUSINESS COMMITTEE HOLDING HEARINGS TO RECEIVE RECOMMENDATIONS OF SMALL BUSINESS GROUPS REGARDING THE COMMITTEE'S AGENDA FOR THE 99th CONGRESS

FEBRUARY 6, 1985

I am Herbert Liebenson, President of the National Small Business Association and Executive Director of the Small Business Legislative Council. The National Small Business Association (NSB) is a multi-industry trade association, representing approximately 50,000 small business firms nationwide. The Small Business Legislative Council (SBLC) is a coalition of 88 national trade and professional associations representing over 4 million small firms, nearly one-fourth of all small firms in the nation.

The Small Business Legislative Council's Chairman, Walter Galanty, Executive Director of the National Association of Brick Distributors, will review the SBLC's priorities for the Committee later this morning.

Last September, the Board of Trustees of the National Small Business Association met to establish priorities for the 99th Congress. Rather than go through each of the top twenty issues, I am attaching a list for your information.

In order to conserve time, I would like to comment on three issues, one of which is contained in our priority list and two additional issues which have become prominent since our September meeting.

First, let me address the issue of Tax Reform which heads our list of priorities.

NSB is deeply disturbed over the Treasury's tax proposal of November 1984. The plan is presented as revenue neutral, but there is a major increase for small corporations which we represent.

Treasury would change the present graduated corporate rate structure to a flat 33% tax for all companies. For the major corporations earning over $100,000, the tax rate would fall from 46% to 33%. In contrast, for companies earning less than $100,000, the 4-step graduation that this Committee fought for over a decade would be eliminated. This would mean that taxes would be increased for all corporations earning less than $100,000, over 90% of all corporations.

For example, the company with taxable income over $50,000 would experience a 100% increase in its tax bill while a company earning $5 million would have a 28% tax decrease. This is illustrated in a table which we have attached to our statement as an appendix. As the table indicates, over a 5-year period, large corporations would enjoy a rate reduction totaling $204 billion dollars. During the same period, small corporations would suffer a tax increase of $31.2 billion. The base-broadening increases in the capital recovery area (depreciation and investment tax credit) would increase taxes for large and small corporations alike. Thus, while the majority of unincorporated, individual businesses would receive tax reductions under the individual rate schedules and large corporations would receive tax reductions under the flat corporate rate, small corporations would end up with tax increases and consequently bear a disproportionate share of the tax burden as envisioned by this proposal. We strongly oppose this provision in the Treasury's tax proposal.

Second, an issue which arose subsequent to our meeting that determined the association's priorities but which, nonetheless, has commanded our concern and attention is the proposal to abolish the Small Business Administration.

That proposal is, in the opinion of our association, shortsighted. It does not take into account the significance of small businesses' impact on the economy and the stimulus that SBA programs provide to small business growth and stability.

Small business has been the bellwether in our recent economic recovery, establishing more than a half million new businesses and creating over two and a half million new jobs.

The value added to the economy in terms of jobs created and revenue generated by the firms that SBA assists not only through its lending programs, particularly those made in concert with the nation's banks, but through its critically important procurement and management assistance programs has a dramatic impact in maintaining our economic growth and would have a far more salutary, long-term effect in reducing the deficit than the questionable short-term monetary savings that might result from dismantling the agency.

Highly placed officials in the Department of Commerce have stated publicly that small business productive units will replace big business as the base of our national economy in the next decade. Thus, continued support of small business is in the nation's best interests.

This is not to say that cost effective improvements cannot or should not be made in the SBA. They should. NSB has been and continues to be critical of agency programs whenever we feel that constructive criticism is warranted and that SBA programs or the administration of those programs is not serving the best interests of small business and the economy.

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What is most alarming about the proposal to abolish SBA is that it would destroy the independence of action that more than 30 years of experience has taught us is absolutely paramount to the successful conduct of small business matters in the Executive Branch. Abolishing the SBA would relegate small business issues to a secondary status that is totally unwarranted in view of small business' contribution to the nation's economic welfare and subordinate or at the very least, place serious limitations on the latitude of small business representation in the Executive Branch.

The authority and independence that Congress vested in the Office of the Chief Counsel for Advocacy has proved critical in what that office has accomplished on behalf of small business in the Executive Branch and allows small business to participate in national policy decisions that affect it, a prerogative it would not otherwise enjoy. It is imperative that small business retain that capability.

A third area that is of concern to NSB relates to innovation and emerging technology.

For many decades, the Department of Commerce has, in the view of many, represented the interests primarily of big business.

However, the current Administration created within the Department of Commerce, the Office of Productivity, Technology, and Innovation (OPTI) which has provided a needed impetus to small business growth and development options which inure to the benefit not only of small business, but to the favorable development of the U. S. economy in general. The abolition of OPTI and its related activities would create a void which no other section of the Executive Branch is equipped to fill.

NSB supports the continuation of OPTI. It should be encouraged to continue its research into the concept of "shared facilities" for small business known as "flexible manufacturing" centers, and similar concepts which are vital to the strength of the economy and, in the longer term,

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the ability of the U. S. to compete on a global basis.

The office should ensure the continuation of the Office of Metric Programs since the problems of metric transition to the universal world measurement system are of particular concern to small business and not the large multinational businesses which either have or are converting unilaterally to the metric system.

That concludes my statement. I would be pleased to answer any questions you may have.

N S B PRIORITIES - September 1984

- FEDERAL DEFICIT
- TAX REFORM
- HEALTH CARE COST CONTAINMENT
- INCREASING SMALL BUSINESS ACCESS TO EQUITY CAPITAL
- GRADUATED CORPORATE INCOME TAX
- PAYROLL TAXES
- FEDERAL ESTATE AND GIFT TAX
- TAX DEFERRAL ON REINVESTMENT OF CAPITAL GAINS IN QUALIFYING SMALL BUSINESSES
- THE GROWTH OF NON-BANK BANKS
- SMALL BUSINESS LOAN INSURANCE
- GENERAL JOBS TAX CREDIT
- ACCUMULATED EARNINGS TAX
- INTERNATIONAL TRADE POLICY
- INTERNATIONAL TRADE INCENTIVES/DISINCENTIVES
- GOVERNMENT PROCUREMENT
- SMALL BUSINESS ADMINISTRATION
- FREEDOM OF INFORMATION ACT REFORM
- GOVERNMENT COMPETITION: DIRECT AND INDIRECT
- PRODUCT LIABILITY
- UTILITY RATEMAKING AND TELECOMMUNICATIONS

EFFECT ON SMALL COMPANIES OF

TREASURY CORPORATE TAX RATE PROPOSAL*

NOVEMBER 27, 1984

Taxable Income	Present Law			Proposal		Change in Average Tax Rate	Change in Tax
	Marginal Rate	Average Rate**	Tax	Rate	Tax		
$ 25,000	15%	15.00%	$ 3,750	33%	$ 8,250	+120.00%	+$ 4,500
$ 50,000	18%	16.50%	$ 8,250	33%	$ 16,500	+100.00%	+$ 8,250
$ 75,000	30%	21.00%	$ 15,750	33%	$ 24,750	+57.14%	+$ 9,000
$ 100,000	40%	25.75%	$ 25,750	33%	$ 33,000	+28.16%	+$ 7,250
$1,500,000	46%	46.00% ***	$690,000	33%	$495,000	-28.26%	-$195,000

* Covers impact of rate proposal on corporations only. Does not include possible impact of changes in capital recovery (ITC and depreciation), capital gains, dividends, benefits, IRA's, IDB's fringe benefits, retirement benefits, ISO's or other areas upon incorporated or unincorporated businesses.

** The average rate is the numerical average of the rates applying to the various brackets in which the company has income. For example, if the company has $50,000 of taxable income, it will have $25,000 taxed at 15% and $25,000 taxed at 18% for an average rate of 16.5%. This composite rate is the actual rate at which the company is taxed.

*** Effective for tax years beginning after December 31, 1983.

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STATEMENT OF
JOHN J. MOTLEY III

DIRECTOR OF FEDERAL LEGISLATION

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: The Senate Committee on Small Business
Subject: Presentation of NFIB Legislative Priorities
Date: February 6, 1985

Mr. Chairman, on behalf of the more than 500,000 members of the National Federation of Independent Business, I would like to thank you for this opportunity to share with the Committee our legislative priorities for the 99th Congress.

This Congress is one of much promise for small business but also one posing many challenges. Already we must address the President's proposal to terminate the Small Business Administration, even as we struggle with the burden of the deficit. Many key small business objectives remain unmet from previous Congresses, and many new problems and new solutions have yet to be examined and debated. NFIB looks forward to working with this Committee to meet these challenges and to fulfill the promise a new Congress offers.

The most important item on the NFIB legislative agenda is deficit reduction. Our members have made it clear through their votes that they want the deficit down now, and they prefer that this be accomplished through a comprehensive budget freeze. While we must be prepared to do our share in reducing the deficit, the federal budget cannot be balanced on the back of small business. In this vein, NFIB opposes termination of SBA. As detailed in our recent proposal (which I submit here for publication), NFIB would continue the agency in a more efficient and responsible form, reducing its cost by 65% but ultimately saving more budget dollars than under the original Stockman proposal. We look forward to testifying on this subject when the Committee takes up SBA authorization later this month.

NFIB remains committed to reducing the burden of government on small firms, and our legislative priorities reflect this commitment. We are anxious to see the reauthorization of the Paperwork Reduction and Equal Access to Justice Acts, and we are hopeful that this Committee will play an active role in securing these goals. Among other issues pressing for legislative attention, NFIB would highlight the need to repeal or reform new tax law with respect to imputed interest and auto logs, and the need to address the burden that telephone access charges are placing on small businesses. We hope these issues will be among the first to be considered and resolved by Congress in these next few months.

In many other areas, also, the role of government needs to be lessened. NFIB is particularly concerned about restrictive or burdensome labor laws and the problem of government competition with small firms.

NFIB supports reform of banking law to preserve distinctions between banking and other forms of commerce. We believe there is much room for this Committee to examine what the financial needs of small businesses are in the context of a rapidly changing financial services industry and to take part in shaping legislation to reconcile banking policy and realities in that industry. We request that the Committee consider creating an ad hoc task force to examine this issue, so it can assist the Banking Committee and the full Senate in understanding the importance of bank financing to smaller firms.

For the Committee's reference I am submitting a copy of NFIB's detailed Legislative Priorities. In it members will find our specific approaches to the general problems I have identified today. There is much work to be done in addressing these priorities, but NFIB is confident that the productive relationship we have enjoyed with this Committee will continue and will aid us in our mutual goal of serving the small business community.

Thank you.

0167T
SA/sa

Statement of John Sloan, President and CEO,
National Federation of Independent Business

January 3, 1985

Through the honored Washington tradition of selective media leaks, OMB Director David Stockman has made it known that one way the administration will propose to reduce the federal deficit will be to abolish the Small Business Administration.

As the voice of more than a half-million small and independent businesses throughout the country, the National Federation of Independent Business has been a frequent critic of the SBA. The agency has had major problems in the past. It continues to do many things it should not do. And, much of what it should be doing, it does poorly. However, we feel that killing the SBA would be a mistake--both politically and economically.

It is not difficult to see why Mr. Stockman has targeted the SBA for elimination. It is a relatively low-risk proposal from a political fall-out perspective. The apparent risk of alienating the small-business community is somewhat less than meets the uninformed eye.

As we at NFIB have made clear both in Congress and throughout the executive branch, the number one priority of the small-business community is cutting the federal deficit. Small-business dissatisfaction with major elements of SBA programming--especially its direct loan operations and its management assistance programs--also are well-known to Mr. Stockman and others. A proposal to shut down the agency thus has a certain cosmetic appeal to what one would assume to be the naturally aggrieved constituency: It would remove failed programs which have disappointed most small-business owners, at the same time apparently moving toward the higher goal of a balanced budget.

Unfortunately, abolishing the agency would throw out the good programs with the bad. And, it would appear that the financial benefits being claimed for such an action have been grossly overstated.

Examining this last point first, the Office of Management and Budget claims that eliminating the SBA would save $5.3 billion over a three-year period (according to reports in the Wall Street Journal). Considering that the annual agency appropriation rose to only $700 million for FY'85, it is difficult to justify a paper-savings of much more than $2 billion over three years--unless, as rumored, part and parcel of the shutdown would be selling off the agency's loan portfolio.

If such a sell-off is behind the $5.3 billion figure, it appears that Mr. Stockman has grossly overvalued SBA assets. The SBA's loan portfolio has a current face value of only $9.5 billion (including $1.2 in guaranteed loans bought back from the Federal Financing Bank). When last evaluated, the SBA learned that its portfolio could fetch, at best, 18 cents on the dollar on the open market--yielding a one-shot revenue gain of only $1.7 billion...about half of the amount apparently being projected by OMB.

By contrast, if the SBA were allowed to continue -- and do nothing more than service its outstanding loans -- the government could expect to recover at least $7.5 billion from these loans over a five to seven year period. In other words, shutting down the agency and selling off its portfolio would end up costing the taxpayer, in lost loan repayments, almost exactly the same amount that OMB is falsely claiming would be saved. That's no way to fight a deficit.

What should be done, then, to help the SBA do its job in a way that will (1) satisfy the real and legitimate needs of the small-business community and (2) help bring down the federal deficit? The answer is to get rid of the programs that cost far more than they produce, to revamp programs that are salvageable so that they become more cost-efficient and retain the programs that are working.

One sector ripe for the cutting appears to be the Direct Loan programs. In FY '84, the SBA floated direct loans, exclusive of its Physical Disaster Loan program, valued at $242.3 million. The cost of this program--not counting salary and expenses--was $180 million.

The direct loan programs historically have been plagued by sky-high default rates. The good news is that, by working collections aggressively, the SBA has cut its delinquency and default rate by about half since 1981. The bad news is that this improvement means the FY '84 default rate on direct loans ran at about 24 percent.

This rate is unacceptably high, posing unacceptably high costs to taxpayers. Given the small number of loans made under this program (2,234 in FY'84), their absence would hardly be noticed among the small-business community.

Consequently, we recommend eliminating the Direct Loan program. In addition to saving $180 million annually in program costs, this would allow the Finance and Investment division to cut back on some personnel, at an estimated annual savings of $5 million in salaries and expenses.

The Loan Guarantee program underwrote $3.28 billion in loans in FY'84. These loans had a default rate of about 10 percent--not nearly as poor a record as registered by the direct loan program, but still too high. Here, we recommend continuation of several innovations recently inaugurated and the loan guarantee approval process, and we recommend two fundamental changes in the entire program.

The three innovative practices we favor are the Secondary Market Resale program, the Preferred Lender Program, and the Certified Lender Program. The secondary market program allows the SBA to leverage its guarantee money by selling its guaranteed loans and recycling that money into new guarantees. This gives the agency a bigger bang for its guarantee buck, enabling it to serve more borrowers.

The lender programs trim the administrative costs of the program by placing responsibility for loan application analyses with the lending institutions rather than with SBA personnel. This not only cuts SBA's "people" costs, it also should result in a higher quality portfolio, as the analyses are performed by lending professionals in the local area who are better attuned to the realities of local financial and economic conditions. Additionally, the Preferred Lender program reduces SBA exposure on loans to only 70 percent, rather than the more usual 90 percent. And finally, both programs assure a quick decision for the loan applicant, getting rid of the long turn-around time that has plagued loan applications handled by SBA personnel.

As for programming changes, first we would eliminate the "targetted" types of loan guarantees--monies earmarked for use among only handicapped or minority group entrepreneurs. These guaranteed loans have a higher-than-SBA-average loss rate because they are less-well secured. By channeling all loan guarantees through the general business loan category and holding would-be borrowers to reasonable standards of collateral, the default rate can be substantially reduced.

Secondly, we would restructure the entire loan guarantee program so that it results in no net cost to the taxpayer. This would be achieved by raising the fee charged for loan guarantee origination. Currently, borrowers pay one point for a loan guarantee. In the private marketplace, the going rate is 7 points. We would recommend boosting the fee to at least 3, and possibly 5 points.

Assuming the size of the loan guarantee program were temporarily frozen at the $2.6 billion level of the FY '84 General Business program, a 5-point fee would produce income of $104 million for the SBA. This would offset both the $58 million in administrative costs of the entire loan program and the estimated $26 million in immediate costs of the program, leaving $20 million for a loss-reserve fund. The ultimate goal would be to amass a reserve pool large enough to make the entire loan guarantee program self-funded.

Obviously, it would take years to build the loss-reserve to the point where it would be completely self-sustaining. However, if repayments of outstanding direct loans were channelled into the loss-reserve for the next two years, the pool would grow to approximately $3 billion. This would be sufficient to make the loan guarantee program fully self-sufficient, and it could be expanded ad infinitum from there on, at no cost to the taxpayer.

We believe that two disaster loan provisions revived last year by Congress--the non-physical disaster loan program and the disaster loan eligibility for farmers--should be scrapped. This would keep the physical disaster loan fund from being overextended and would eliminate the $100 million appropriated for non-physical disasters.

How about non-loan programs at the SBA? SBA's procurement division, which reviews government contracts to identify opportunities for small-business contractors, has an annual budget of $12 million--all for personnel and expenses. While this may appear to be a candidate for "loss-leader," the program has been quite successful in putting out contracts for competitive bids by small firms.

Actually, this program is one of the government's best tools for making $700 coffee pots a nightmare of the past. It is conservatively estimated that, by moving some $160 billion worth of contracts to small firm bidding competition, government procurement agencies saved at least $75 million. Thus, this program saves the taxpayer $6 for every dollar it spends. It should be retained.

SBA's Management Assistance program is the least efficient division within the agency. Currently, it expends $22 million annually in program monies--most of them going to Small Business Development Centers. The SBDC program has been a bust. However, last year Congress for the first time authorized the SBA to work with for-profit business management firms to provide counseling. This approach has some merit--in that it overcomes the basic obstacle to acceptance encountered by the SBDC program: It allows the agency to provide guidance from private management consultants rather than academics. Small-business owners tend to discount the value of advice from professors. It is this misgiving that has seriously hampered the ability of the SBA to reach a wider audience with valuable management assistance.

We propose that this new approach be given a three-year trial run. During that time, the workshops and conferences should not be offered for free. Rather, participants should be charged a modest fee, sufficient to offset part of the SBA's administrative costs, but not so large as to discourage participation. No programing costs should arise, as the for-profit firms are expected to contribute their time and talent for free (with the idea that they will be making contacts in the small-business community that will pay off for them later). This stands in marked contrast to the SBDC price tag of $22 million in program costs. If, after the three-year trial period, the private consultant program cannot demonstrate greater acceptance and use among the business community, it should be abolished.

The final and newest program area at the SBA is advocacy. This is the function most prized by the small-business community--having its own eyes, ears and mouth within the administration to watchdog proposed legislation and regulation and raise legitimate concerns on behalf of the small-business owner. The cost of this division is miniscule--$5.3 million in FY '84. Yet, it is a function of extreme importance to the agency's constituency. We recommend that the range of this office's activities be restricted to Washington, D.C. There is no need to maintain advocacy offices in the regions, as that kind of dispersed voice carries little or no weight within the State Houses. Maintaining only a Washington office should allow Advocacy to cut its expenses by at least 20 percent.

The final cost of SBA operations is in General Management--a $110 million operation in FY '84. With the cutback in SBA programming which we have recommended, this expense also should be able to be trimmed by at least 20 percent.

In sum, our proposals would offset nearly all SBA program costs for the year. Looking at SBA's FY'85 appropriation, our proposal would trim $28 million from the agency's "people costs" (budgeted at $205 million) and $406 million from its program costs (budgeted at $484 million). Thus, we're looking at a one-year savings of $434 million in out of pocket expenses, and three-year savings of nearly $1.5 billion.

Additionally, by retaining the procurement program, we would save the general taxpayer another $225 million over that period. And we would continue collecting the $5.8 billion in direct loan repayments which would otherwise be lost to the government under Mr. Stockman's proposal.

The bottom line: instead of a net loss of $3.8 billion that would result from killing the agency and selling off its loan portfolio, our proposal would maintain essential services for the small-business community at an administrative cost of less than $550 million (over a three-year period) while bringing in loan repayment revenues of $7.5 billion and achieving three-year procurement savings of more than a quarter of a billion dollars.

Our proposal is the more fiscally-responsible. However, implementing it will doubtless cause some pain within the small-business community. We are willing to bite the bullet, to get the deficit under control. But we are not willing to do it alone.

Our proposal would cut agency out-of-pocket expenses by nearly two-thirds. That's far more dramatic than the 27 percent cut-back at SBA which we recommended and helped implement in 1981. I mention that earlier cut-back with good reason. You'll recall that the President asked every agency (except Defense) to pare it's budget by one-fourth in an effort to balance the budget. We took that challenge seriously, and worked hard with the administration and Congress to make it happen at the SBA. Alas, we moved ahead on the fiscal responsibility front alone.

That is why it is so disheartening to hear about the current move to kill the SBA. Small business has, in a sense, already given its pound of flesh in the deficit reduction arena. As I have outlined, we stand ready to give some more, because of the atrocious deficit situation. But there is no way the small-business community can balance the budget on its own. The entire SBA budget is nothing more than pin money when stacked up against federal spending for other major constituencies--big business, organized labor, agriculture and the defense industry to name just a few.

These constituencies, and the bloated bureaucracies which serve them, must be forced to follow our lead. We're realists. We don't expect any of them to match the 62 percent funding cut we are prepared to accept. But we can and do expect them to make major cuts--perhaps as painful as ours. For a benchmark, I would suggest at least a 27 percent reduction all around--the same sacrifice the small-business community made three years ago, shortly before it began to lead this country out its economic recession.

FFI Contact: Dave Cullen or Jim Weidman at (202) 554-9000

RE-CAP OF SAVINGS INHERENT IN NFIB PROPOSALS

SAVINGS TODAY:

$180 million -- Direct Loans not made

$104 million -- New income from guarantee fees

$100 million -- Non-physical Disaster Loans not made

$22 million -- SBDC programing funds not spent

$28 million -- Reduction in Salaries and Expenses

$434 million -- savings beginning in FY 1986
(62% of total SBA appropriation for FY '85)

OTHER POTENTIAL SAVINGS:

$320 million (annually) -- If NFIB Loan Guarantee restructuring is implemented.

$17 million (annually) -- If Management Assistance program fails to work as designed.

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STATEMENT OF FRANCIS R. CARROLL

PRESIDENT

FOR THE

SMALL BUSINESS SERVICE BUREAU, INC.

NATIONAL OPERATIONS CENTER

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WORCESTER, MA 01601

BEFORE THE

SENATE COMMITTEE

ON

SMALL BUSINESS

FEBRUARY 6, 1985

MR. CHAIRMAN, I WANT TO THANK YOU FOR THIS OPPORTUNITY TO ADDRESS THE PRIORITIES FOR THE SENATE COMMITTEE ON SMALL BUSINESS FOR THE 99TH CONGRESS. THE SMALL BUSINESS COMMUNITY OWES SENATOR WEICKER AND THE MEMBERS OF THE COMMITTEE A DEBT OF GRATITUDE FOR THEIR LEADERSHIP AND ADVOCACY ON BEHALF OF SMALL BUSINESS DURING THE 98TH CONGRESS. MY NAME IS FRANCIS R. CARROLL AND I AM HERE TODAY AS PRESIDENT OF THE SMALL BUSINESS SERVICE BUREAU, INC.; AN ORGANIZATION REPRESENTING OVER 35,000 SMALL BUSINESSES ACROSS THE COUNTRY.

I WILL ADDRESS MYSELF THIS MORNING TO ISSUES PARTICULARLY IMPORTANT TO VERY SMALL AND INDEPENDENT BUSINESSES.

FOREMOST AMONG THESE ISSUES IS THE REAGAN ADMINISTRATION'S PROPOSAL TO ELIMINATE THE SMALL BUSINESS ADMINISTRATION. NINETY-EIGHT PERCENT OF AMERICA'S 7.4 MILLION BUSINESSES HAVE 100 OR LESS EMPLOYEES. BOTH PRESIDENT REAGAN AND THE SBA ADMIT THAT THESE BUSINESSES ARE RESPONSIBLE FOR CREATING MOST OF THE NEW JOBS AND INNOVATION IN THIS COUNTRY. THROUGH THE YEARS, THE SBA HAS MEANT THE DIFFERENCE BETWEEN SUCCESS AND FAILURE FOR THOUSANDS OF SMALL BUSINESSES. HOWEVER, WE ARE NOT ASKING THAT THE SBA BE EXEMPTED FROM BUDGET CUTS NECESSARY TO REDUCE THE SOARING FEDERAL DEFICIT. WHILE WE ACKNOWLEDGE THAT THE SBA HAS ITS PROBLEMS, THE ECONOMIC INTERESTS OF THE NATION CAN BE BETTER SERVED BY REDIRECTING THE SBA INSTEAD OF ABOLISHING IT.

THE SBA'S BUDGET IS TWENTY-FIVE PERCENT OF WHAT IT WAS IN 1980, BUT INSTEAD OF PROPORTIONATELY REDUCING ITS ACTIVITIES TO HELP THE TRULY SMALL BUSINESS, THE AGENCY IS TRYING TO SERVE MORE AND LARGER FIRMS. THE SBA SHOULD SCALE DOWN ITS SIZE STANDARDS TO SERVE THE TRULY SMALL FIRMS WITH 100 OR LESS EMPLOYEES WHERE THE REAL JOB GENERATION AND INNOVATION ARE OCCURING IN THIS COUNTRY.

IF THE AGENCY DOESN'T HAVE THE FINANCIAL RESOURCES TO SERVE FIRMS OF 100 OR LESS, IT SHOULD FURTHER SCALE DOWN ITS STANDARDS TO SERVE THOSE WITH ONLY 50 EMPLOYEES OR LESS.

ALSO, THE RECOMMENDATIONS OF THE GRACE COMMISSION IN REGARD TO THE SBA SHOULD BE STUDIED FOR ADDITIONAL SOURCES OF COST SAVINGS. I FEEL THE SBA HAS ABROGATED ITS PRIMARY FUNCTION BY RELEGATING ITS LOAN PROGRAM TO THE BANKS AND ITS MANAGEMENT ASSISTANCE PROGRAM TO COLLEGES THROUGH THE SMALL BUSINESS DEVELOPMENT CENTERS. SBA SHOULD PUT ITS MONEY WHERE IT WILL GET THE BEST RETURN BY BRINGING BACK LOW INTEREST DIRECT LOANS AND ORGANIZING EFFECTIVE PROGRAMS LIKE SCORE, THE SERVICE CORPS OF RETIRED EXECUTIVES. THE SERVICES OFFERED THROUGH SMALL BUSINESS DEVELOPMENT CENTERS ARE DUPLICATING SERVICES PROVIDED BY THE PRIVATE SECTOR MORE EFFICIENTLY AND EFFECTIVELY. SBDC FUNDING COULD BE BETTER UTILIZED BY REVIVING SCORE, A **PROVEN** PROGRAM OF SOLID MANAGEMENT ASSISTANCE THAT HAS BEEN CUT TO THE BONE IN SPITE OF ITS EFFECTIVENESS.

IN 1983, THE AGRICULTURE DEPARTMENT HAD A BUDGET OF $40 BILLION. THIS WORKS OUT TO $17,000 SPENT ON EACH FARM IN AMERICA. HOW CAN THE ADMINISTRATION IN GOOD CONSCIENCE SCRAP THE SBA, THE **ONLY** PROGRAM TO HELP SMALL BUSINESS, WHEN SO MUCH IS BEING SPENT TO SUBSIDIZE FARMING?

DAVID STOCKMAN WAS QUOTED AS SAYING, "THERE IS NO ROOM IN THIS ADMINISTRATION FOR PUBLIC-SECTOR INTERVENTION IN THE FINANCIAL MARKETPLACE." HOW CAN THE PRESIDENT SUBMIT A ZERO BUDGET FOR OUR ONLY SMALL BUSINESS PROGRAM, WHILE HE IS CUTTING DEALS TO PROVIDE LOAN GUARANTEE INCREASES FOR OUR FARMS? IT SEEMS TO ME THAT FAIR BUDGET CONSTRAINT HAS GONE OUT THE WINDOW IN FAVOR OF POLITICAL CLOUT.

LARGE BUSINESSES GET ENOUGH HELP FROM THE GOVERNMENT THROUGH INDUSTRIAL REVENUE BONDS AND EXPORT-IMPORT BANK LOANS. THE SBA MUST STOP TRYING TO BE ALL THINGS TO ALL BUSINESSES AND CONCENTRATE ITS ENERGY ON PROVIDING ASSISTANCE TO THE NATION'S TRULY SMALL BUSINESSES.

ANOTHER AREA OF CRUCIAL CONCERN TO OUR MEMBERS IS THE TREASURY'S PROPOSED HEALTH CARE TAX CAP. THIS PIECE OF PROPOSED LEGISLATION, PREVIOUSLY SPONSORED BY SENATOR ROBERT DOLE, WOULD HAVE A DRASTIC EFFECT ON THE SMALL BUSINESS COMMUNITY AND ALL WORKING AMERICANS. OVER FIFTY-FIVE PERCENT OF THE MEMBERS OF THE SMALL BUSINESS SERVICE BUREAU, INC. WOULD BE SUBJECT TO THIS TAX.

TAXING EMPLOYER-PAID HEALTH PREMIUMS IS **NOT** THE SOLUTION TO REDUCING THE FEDERAL DEFICIT OR RISING HEALTH CARE COSTS. THE SMALLEST FIRMS ALREADY PAY THE **HIGHEST PREMIUMS** FOR HEALTH INSURANCE COVERAGE. THE HEALTH CARE TAX CAP WILL ADD ANOTHER TAX INCREASE TO ALREADY OVERBURDENED SMALL BUSINESS OWNERS AND THEIR EMPLOYEES.

WE BELIEVE THE TAX CAP HAS SEVERAL MAJOR DISADVANTAGES:

A. IT DISCRIMINATES AGAINST THE SELF-EMPLOYED AND THE VERY SMALL BUSINESS, WHO ALREADY PAY MORE FOR THEIR HEALTH INSURANCE THAN DO THEIR LARGE CORPORATE COMPETITORS.

B. THE TAX ON HEALTH INSURANCE PREMIUMS WILL BE COMPLEX AND VERY **COSTLY TO ADMINISTER.** ALREADY SMALL BUSINESSES ARE SADDLED WITH FEDERAL PAPERWORK AND COMPLEX ACCOUNTING SYSTEMS - THIS WILL ONLY EXACERBATE A BAD SITUATION.

C. A NATIONAL UNIFORM CAP WILL BE **INEQUITABLE.** EMPLOYEES IN STATES WITH HIGH HEALTH CARE COSTS DUE TO LEGISLATIVELY MANDATED BENEFITS WILL BE PENALIZED UNFAIRLY, THUS HURTING LOCAL ECONOMIES WHER BUSINESSES ARE ALREADY COMPETING UNDER HIGHER COSTS.

D. EMPLOYEES WILL DEMAND **NEW AND/OR ADDITIONAL BENEFITS** FROM THEIR EMPLOYERS, TO COMPENSATE FOR THE TAX. SMALL BUSINESS OWNERS CANNOT AFFORD TO OFFER ADDITIONAL BENEFITS - UNLIKE BIG BUSINESS.

E. THE TAX CAP WILL **DISCOURAGE** SMALL EMPLOYERS FROM HIRING ELDERLY AND DISABLED WORKERS. IN ORDER TO KEEP THE HEALTH PREMIUMS BELOW THE FEDERAL LIMIT, EMPLOYERS WILL AVOID HIRING THESE GROUPS IN FAVOR OF YOUNGER WORKERS WHO ARE BETTER HEALTH RISKS.

AS CONCERNED MEMBERS OF THE BUSINESS COMMUNITY, THOSE SMALL BUSINESSES WE SURVEYED SUPPORTED THE OVERALL NEED TO REDUCE THE FEDERAL DEFICIT AND TO LOWER PRESENT HEALTH CARE COSTS. HOWEVER, TAXING EMPLOYER-PAID HEALTH INSURANCE BENEFITS IS NOT THE WAY TO ACCOMPLISH THAT.

INSTEAD, SMALL BUSINESS SERVICE BUREAU, INC. BELIEVES THAT REDUCED INFLATION, LOWERED INTEREST RATES, AND CUTTING OUR FEDERAL SPENDING WILL RESULT IN A STABLE ECONOMY. THIS WILL STIMULATE OUR GROWTH AS A NATION AND REVIVE CONSUMER PURCHASING POWER AND IS THE BEST POSSIBLE MEANS OF REDUCING OUR FEDERAL DEFICIT. WE AGREE WITH PRESIDENT REAGAN THAT ANY INCREASES IN TAXES WILL ONLY STIFLE THE RECOVERY.

ANOTHER RELATED ISSUE WE WISH TO ADDRESS TODAY, MR. CHAIRMAN, IS THE TREASURY TAX REFORM PROPOSAL, MANY PROVISIONS OF WHICH WILL BENEFIT LARGE CORPORATIONS AT THE EXPENSE OF SMALL BUSINESS.

A. UNDOUBTEDLY, THE MOST INEQUITABLE ELEMENT OF THE TAX REFORM PACKAGE IS THE PROPOSED FLAT TAX OF 33% ON ALL CORPORATIONS. WHILE THIS MAY BE A BOON TO THE EXXONS AND IBMs, IT WILL DEVASTATE SMALL BUSINESSES WITH EARNINGS UNDER $100,000. FOR EXAMPLE, SMALL COMPANIES CURRENTLY PAYING AT THE 16% MINIMUM RATE WOULD FACE AN **INCREASE IN TAXES OF OVER 100%,** WHILE LARGE CORPORATIONS WHO ARE NOW PAYING THE MAXIMUM TAX OF 46% FOR INCOME OF $100,000 OR MORE WILL RECEIVE A **30% DECREASE IN TAXES.** IN ADDITION, OWNER/OPERATORS WILL BE SUBJECTED TO A DOUBLE TAX BY VIRTUE OF HAVING TO PAY PERSONAL INCOME TAX **IN ADDITION TO** CORPORATE TAX. LOWER TIERS SHOULD BE ESTABLISHED FOR SMALL BUSINESSES, WHO WILL NOW FACE A PROPOSED DOUBLING OF THEIR TAXES IF THIS PROPOSAL IS ADOPTED AS IS.

B. ON THE ISSUE OF CAPPING BUSINESS MEAL DEDUCTIONS, THE IRS PROPOSES TO PUNISH THE MAJORITY OF BUSINESS PEOPLE WHO USE THIS DEDUCTION HONESTLY BECAUSE OF THE FEW WHO ABUSE THIS PRIVILEGE. BUSINESS MEALS ARE A LEGITIMATE, PROPER ACTIVITY. MANY IMPORTANT BUSINESS DEALS AND DECISIONS ARE MADE OVER WORKING BREAKFASTS, LUNCHES AND DINNERS. THE BUSINESS MEAL IS AN ESSENTIAL TOOL, NOT A FRIVOLOUS PERK. THE "THREE MARTINI LUNCH" IS A BIG BUSINESS, NOT SMALL BUSINESS PHENOMENON. SMALL BUSINESS PEOPLE WASTE NEITHER THEIR TIME OR MONEY ON LIQUID LUNCHES.

LIMITING BUSINESS MEAL DEDUCTIONS WILL ADVERSELY AFFECT RESTAURANTS WHICH RELY ON BUSINESS CLIENTS FOR A SUBSTANTIAL PORTION OF THEIR BUSINESS. FOR SMALL RESTAURANT OPERATIONS, THIS COULD MEAN DISASTER. FURTHERMORE, THE CAP INCLUDES TAX AND TIP, AND THE LIMITATIONS IMPOSED DO NOT TAKE INTO ACCOUNT REGIONAL PRICING DIFFERENCES. TAKING A CLIENT TO LUNCH IN NEW YORK OR WASHINGTON, D.C. IS MORE EXPENSIVE THAN DINING A CLIENT IN PEORIA. IN ADDITION, THE LACK OF AN INDEXING ELEMENT FOR INFLATION WILL SOON DEVALUE A CAPPED DEDUCTION, EVENTUALLY RENDERING IT WORTHLESS.

A STUDY CONDUCTED BY CHASE ECONOMETRICS FOR THE NATIONAL RESTAURANT ASSOCIATION DETAILS THE DETRIMENTAL IMPACT THAT MEAL CAPPING WILL HAVE NOT ONLY ON THE FOOD SERVICE INDUSTRY BUT ON THE ECONOMY AS A WHOLE.

TAX REVENUE WILL BE REDUCED ON THE FEDERAL STATE AND LOCAL LEVELS DUE TO DECREASED SALES. GOVERNMENT OUTLAYS FOR UNEMPLOYMENT COMPENSATION AND WELFARE WILL INCREASE AS EMPLOYEES ARE DISPLACED.

DURING THE 1980 CAMPAIGN, PRESIDENT REAGAN VOICED STRONG SUPPORT FOR CONTINUING FULL DEDUCTIBILITY FOR BUSINESS MEALS. WE ASK TODAY THAT THE ADMINISTRATION AND CONGRESS ADHERE TO THAT COMMITMENT.

MR. CHAIRMAN, I MUST PROTEST IN THE **STRONGEST** TERMS THE NEWLY EFFECTED LAW REQUIRING "CONTEMPORANEOUS" RECORD-KEEPING FOR CARS AND OTHER EQUIPMENT USED FOR PERSONAL AND BUSINESS APPLICATIONS. SOME OF THE PROVISIONS OF THIS NEW LAW ARE ABSURD. IN MANY SMALL BUSINESSES, THE CAR IS A MAJOR ASSET. THE NEW "CONTEMPORANEOUS" RECORD-KEEPING REQUIREMENTS COMBINED WITH THE COMPLEX DEPRECIATION RULES MAKE COMPLIANCE A NIGHTMARE, ESPECIALLY FOR INDEPENDENT SALESPEOPLE, WHO RELY HEAVILY ON THEIR CARS TO DO THEIR BUSINESS. THEY WILL BE SPENDING AS MUCH TIME FILLING OUT RECORDS OF HOW FAR THEY TRAVELLED, TO WHERE, AND WHY, AS THEY WILL SPEND CALLING ON THEIR ACCOUNTS. WE ESTIMATE THAT THE TIME AND EXPENSE INVOLVED IN COMPLYING WITH THIS NEW LAW WILL COST A SMALL BUSINESS ON AVERAGE $1,000 PER VEHICLE. THIS NEW LAW IS ANTI-SMALL BUSINESS. STEPS SHOULD BE TAKEN IMMEDIATELY TOWARDS REPEALING THIS DETRIMENTAL PROVISION.

WE HOPE THAT THE IRS WILL ENACT THE SUBSTANTIVE CHANGES THEY HAVE BEEN HINTING AT IN THE NATIONAL MEDIA.

ANOTHER ISSUE OF MAJOR CONCERN TO THE INTEGRITY OF THE NATION'S SMALL FIRMS INVOLVES BANK DEREGULATION.

THE MAN RONALD REAGAN PUT IN CHARGE OF ANTI-TRUST, WILLIAM BAXTER, TOLD A CONGRESSIONAL COMMITTEE, "THERE IS NOTHING WRITTEN IN THE SKY THAT THIS WORLD WOULD NOT BE A PERFECTLY SATISFACTORY PLACE IF THERE WERE ONLY 100 COMPANIES."

HE IS OBVIOUSLY IGNORANT OF THE FACT THAT ALL NET NEW JOBS CAME FROM SMALL BUSINESSES DURING THE RECENT RECESSION. TO PROCEED WITHOUT ACKNOWLEDGING THAT FACT ENDANGERS THE FREE ENTERPRISE SYSTEM ON WHICH OUR ECONOMY IS BASED.

THIS ATTITUDE IS NOT ONLY WRONG, BUT IT IS RESPONSIBLE FOR A DANGEROUS TREND IN THIS COUNTRY THAT IS CONSUMING SMALL BUSINESS OPPORTUNITIES IN EVERY SECTOR. WHILE THE NUMBER OF SMALL BUSINESSES IN THIS COUNTRY REMAINS STRONG, THEIR SHARE OF THE GROSS NATIONAL PRODUCT HAS DECREASED STEADILY FROM 43 PERCENT IN 1976 TO 38 PERCENT TODAY.

AS BIG BUSINESS IDENTIFIES PROFITABLE AREAS WITHIN THE SMALL BUSINESS ECONOMY, IT HAS BOUGHT OR FORCED OUT LOCAL MOM AND POP OPERATIONS. THE INDEPENDENT GAS STATION IS NOW A COMPANY-OWNED OUTLET. THE CORNER GROCER IS NOW A SEVEN-ELEVEN CHAIN. THE LOCAL BUTCHER IS NOW BEHIND THE MEAT COUNTER AT THE SUPERMARKET. IF THE TREND CONTINUES, SOON THE INDEPENDENT INSURANCE AGENT WILL BE SITTING BEHIND A DESK AT THE CHASE MANHATTAN BANKING CENTER.

TODAY'S INSURANCE AGENT IS AN EXPERT IN HIS FIELD AND USUALLY REPRESENTS SEVERAL COMPANY'S PRODUCTS. FOR THE MOST PART, INSURANCE AGENTS ARE HARD-WORKING, CONSCIENTIOUS PEOPLE DEEPLY INVOLVED IN THEIR COMMUNITIES. THEY HAVE A STAKE IN THEIR COMMUNITIES AND A STAKE IN THEIR CLIENT'S WELL-BEING. THEY PROVIDE THE RIGHT INSURANCE AT THE RIGHT PRICE.

THEY ALSO PROVIDE PEOPLE WITH THE PERSONAL, INDIVIDUAL SERVICE THAT CANNOT BE DELIVERED BY CONGLOMERATE FINANCIAL INSTITUTIONS. HOWEVER, THESE SMALL, BUT EXPERT, COMMUNITY-BASED AGENTS CANNOT COMPETE WITH THE VAST WEALTH OF THE BANKS. THEIR DEMISE WILL NOT HURT ONLY THE CONSUMERS WHOSE INTEREST THEY PROTECT, BUT THEIR COMMUNITIES AS WELL.

CLOSE SCRUTINY IS NEEDED TO ENSURE THAT THE CONSUMER IS FREE OF COERCION WHEN SEEKING CREDIT FROM LENDERS WHO HAVE THE POWER TO PRESSURE HIM INTO PURCHASING INSURANCE IN ORDER TO SECURE A LOAN. THE CONSUMER MUST MAINTAIN HIS FREEDOM TO PURCHASE HIS INSURANCE FROM WHOMEVER HE CHOOSES, IN WHATEVER AMOUNT HE CHOOSES, AT THE BEST POSSIBLE PRICE HE CAN GET. THIS IS WHERE THE SMALL INDEPENDENT INSURANCE AGENTS HAVE FUNCTIONED MOST EFFECTIVELY THROUGHOUT THE YEARS.

THE NATION'S BEST INTEREST WILL CONTINUED TO BE SERVED BEST BY INSURANCE AGENTS WHO HAVE A STAKE IN THEIR CLIENTS AND IN THEIR COMMUNITIES - UNDER THE WATCHFUL EYE OF WELL-EQUIPPED STATE REGULATORS. BUT TO RELATE THIS ISSUE TO THE BROADER PICTURE, THE INDEPENDENT INSURANCE AGENT, FOR THE ECONOMIC GOOD OF THIS COUNTRY, SHOULD NOT BE ALLOWED TO GO THE WAY OF THE INDEPENDENT GAS STATION, THE CORNER GROCER, AND THE LOCAL BUTCHER. NEITHER THE BEST INTEREST OF THE PUBLIC, THE NATIONAL ECONOMY, OR THE AGENT WILL BE SERVED WHEN HE TAKES HIS SEAT BEHIND THAT DESK AT THE CHASE MANHATTAN BANK.

IT SHOULD ALSO BE NOTED THAT THE PUSH FOR DEREGULATION IS BEING SPEARHEADED BY THE BANKING INDUSTRY, NOT CONSUMERS. TO QUOTE CONGRESSMAN ST. GERMAIN, CHAIRMAN OF THE HOUSE BANKING COMMITTEE, "DEREGULATION CANNOT BE FOR THE INDUSTRY ALONE...IT HAS NO MEANING UNLESS IT DOES MEET THE BASIC NEEDS FOR FINANCIAL SERVICES - NEEDS OF THOSE SEGMENTS OF THE POPULATION THAT MAY BE LESS AFFLUENT, LESS ABLE TO MUSCLE THEIR WAY TO THE FRONT OF THE LINE FOR DEREGULATED SERVICES."

EVEN NOW THE BASIC FINANCIAL NEEDS OF MANY, INCLUDING SMALL BUSINESSES, ARE NOT BEING ADEQUATELY MET. WHILE BIGGER BANKS ARE VYING WITH EACH OTHER TO ATTRACT MORE AFFLUENT CUSTOMERS, OTHER CUSTOMERS HAVE TO PAY TOO MUCH FOR BASIC SERVICES, AND IN THE CASE OF SMALL BUSINESSES, BEING DENIED A SERVICE SUCH AS A LOAN, WHICH GO TO LARGER, LESS FINANCIALLY STRAPPED BUSINESSES. OUR MEMBERS CURRENTLY PAY ON AVERAGE, 3% OR MORE ABOVE THE PRIME RATE FOR A LOAN. THE AVERAGE LOAN REQUIRED IS APPROXIMATELY $20,000. MOST BIGGER BANKS DON'T WANT TO BE BOTHERED WITH PROCESSING SUCH A SMALL LOAN, WHEN THEY CAN JUST AS EASILY PROCESS A $200,000 LOAN FOR A WEALTHIER CUSTOMER.

DEREGULATION WILL ONLY COMPOUND THESE WOES. AS WE ENTER THE 99TH CONGRESS, NEW ISSUES IN BANK DEREGULATION NEED TO BE ADDRESSED. WE RESPECTFULLY URGE YOUR SUPPORT OF LEGISLATION WHICH WILL CLOSE THE NON BANK BANK AND "SOUTH DAKOTA" LOOPHOLES, REQUIRE THE DIVESTITURE OF THE 61 EXISITNG NON-BANK BANKS, AND PROHIBIT ALL BANKS FROM MINGLING BANKING WITH SECURITIES FUNCTIONS. THIS WILL END THE CURRENT CONFUSION IN THE BANKING INDUSTRY AND WILL PROTECT THE CONSUMERS AND SMALL BUSINESSES WHICH ARE THE LIFEBLOOD OF OUR FREE ECONOMY.

IN 1982, CONGRESS ENACTED THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT WHICH PROPOSED THAT REAL ESTATE AGENTS AND DIRECT SELLERS BE CLASSIFIED AS INDEPENDENT CONTRACTORS. HOWEVER, THERE HAS BEEN AN ON-GOING CAMPAIGN IN CONGRESS, PRE-DATING TEFRA, WHICH ENDANGERS THE SELF-EMPLOYED STATUS OF INDEPENDENT SLAESPEOPLE, AND MAY FORCE THEM UNWILLINGLY INTO AN EMPLOYEE STATUS.

SPECIFICALLY, THE SALES REPRESENTATIVE PROTECTION ACT, CONSTITUTES AN UNWARRANTED ATTEMPT BY CONGRESS TO DICTATE THE TERMS OF SALES REPRESENTATIVES RELATIONSHIPS WITH THEIR PRINCIPALS BY REQUIRING THE USE OF CONTRACTS BASED ON CERTAIN FEDERAL STANDARDS. CONGRESS IS ASSUMING A PATERNALISTIC ROLE BY SUPERCEDING SELF-EMPLOYED BUSINESSPEOPLE'S RIGHT TO MAKE THEIR OWN DECISIONS AND NEGOTIATE THEIR OWN CONTRACTS.

TO QUOTE ONE OF OUR MEMBERS: "REPRESENTATIVES ARE IN A SELF-EMPLOYED SITUATION AND IF THEY CANNOT OR WILL NOT CONTROL THEIR OWN BUSINESS, THEY SHOULD WORK FOR OTHERS, WHO WILL PROTECT THEM AS "BIG BROTHER" CERTAINLY WOULD ... ONE OF THE REASONS WE ARE SELF-EMPLOYED IS TO HAVE AND KEEP CONTROL OF OUR OWN LIVES."

THE SALES REPRESENTATIVE PROTECTION ACT IS AN UNNECESSARY PIECE OF LEGISLATION WHICH WILL CREATE MORE PROBLEMS THAN IT WILL SOLVE.

PRODUCT LIABILITY REFORM LEGISLATION IS ANOTHER AREA THAT WOULD HELP THE SMALL BUSINESS COMMUNITY.

THE CURRENT SYSTEM DOES NOT SERVE THE BEST INTEREST OF EITHER CONSUMERS OR BUSINESS. CONFUSING AND CONFLICTING STATE LAWS HAVE RESULTED IN BOUNDLESS LITIGATION AND EXORBITANT INSURANCE PREMIUMS, WHICH IN TURN, DRIVE UP THE COSTS OF GOODS FOR CONSUMERS AND INHIBIT INTERSTATE COMMERCE.

SENATOR KASTEN'S BILL WILL CREATE A UNIFORM AND NATIONAL PRODUCT LIABILITY LAW TO BRING ORDER AND EQUITY TO A HODGEPODGE SYSTEM. THE CURRENT SYSTEM IS OF GREATEST BENEFIT TO PRODUCT LIABILITY LAWYERS, WHO POCKET $75 FOR EVERY $67 A VICTIM RECEIVES.

MOST MANUFACTURED GOODS ARE CONSUMED OUTSIDE OF THE STATE WHERE THEY ARE MADE, AND LIABILITY INSURANCE RATES ARE SET ON A NATION-WIDE BASIS. MANY LARGER BUSINESSES HAVE SUCCESSFULLY ORGANIZED INSURANCE COOPERATIVES TO BARGAIN FOR LOWER PREMIUMS. SMALL BUSINESSES ARE AT A DISADVANTAGE HERE AND SO THEY CONTINUE TO PAY HIGHER PREMIUMS.

A UNIFORM NATIONAL PRODUCT LIABILITY LAW WILL GIVE SMALL BUSINESSES THE LEG-UP THEY NEED TO COMPETE EFFECTIVELY. WE BELIEVE THAT SENATOR KASTEN'S BILL WILL FAIRLY AND EFFECTIVELY SAFEGUARD THE RIGHTS AND RESPONSIBILITIES OF CONSUMERS AND MANUFACTURERS ALIKE, AND RESPECTFULLY URGE YOUR ASSISTANCE AND SUPPORT FOR ITS APPROVAL.

WHILE THE TREASURY PROPOSAL ADMITS THAT THE CURRENT ITC AND ACRS DEDUCTIONS ARE OF "LITTLE VALUE TO NEW AND RAPIDLY GROWING FIRMS," IT OFFERS NOTHING TO BENEFIT SMALL BUSINESS. WE PROPOSE MORE FLEXIBLE EXPENSING OF MANY ITEMS TO GIVE CASH FLOW INCENTIVES TO THE FIRM THAT CANNOT WAIT 5 OR 10 YEARS TO RECOVER THE COST OF INVESTMENT. DEPRECIATION HERE MUST TIE IN WITH MORE LUCRATIVE INVESTMENT TAX CREDITS. ALLOWANCE FOR A PARTIAL INVESTMENT TAX CREDIT ON EXPENSED ITEMS SHOULD ECHO THE ITC LEVEL FOR ASSETS HELD FOR IDENTICAL PERIODS.

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STATEMENT OF
ROGER S. VAIL
PRESIDENT, FRED W. UHLMAN & COMPANY
ON BEHALF OF THE
NATIONAL RETAIL MERCHANTS ASSOCIATION
BEFORE THE
SENATE SMALL BUSINESS COMMITTEE
FEBRUARY 6, 1985

Good morning. My name is Roger Vail. I am President of Fred W. Uhlman & Company, located in Bowling Green, Ohio. Today I am here to testify as Chairman of the Board of Directors of the Independent Stores Division of the National Retail Merchants Association.

By way of background, NRMA is the nation's largest trade association for the general merchandise retail industry. Our members operate 40,000 leading department, chain, independent and specialty stores in all 50 states. Their annual sales exceed $150 billion and they employ more than 3 million workers. The vast majority of NRMA's members are small, independent retailers whose annual sales are less than $1 million. Our Independent Stores Division represents the fastest growing segment of our membership.

Taxation and international trade are two major issues which I would like to focus on today. These issues are of the highest priority to general merchandise retailing and are of acute concern to independent retailers.

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Last November, Secretary of Treasury Regan released the Department's Report on Fundamental Tax Simplication and Reform. This report, which proposes a broad-based income tax to lower marginal tax rates for individuals and corporations, and simplifies the Internal Revenue Code, appears to be a more comprehensive effort than other modified flat-tax proposals which have been offered in the past. As such, it has generally been well received by much of the general merchandise retail industry because it recognizes and attempts to alleviate many of the complexities and inequities presently inherent in the U.S. tax code. However, while the Treasury proposal would assist many sizable retailers who have traditionally paid taxes at or close to the highest effective tax rates, one of its elements — the elimination of the graduated corporate tax rate — would have a devastating effect on the nation's smaller companies.

Under the Treasury proposal, as well as under several of the other modified flat tax proposals, the graduated corporate tax rate structure would be repealed or significantly modified. For small businesses, including small retailers, the elimination of the graduated corporate tax rate would dramatically increase their effective tax rates and reduce essential capital available for continued operation and growth. In general, small businesses with less than $150,000 of taxable income would face substantial increases in tax liability with the elimination of the graduated corporate tax rates. (Mr. Chairman, my written statement, which I would like to submit for the record, includes a chart comparing the changes in corporate tax liability under the Treasury Department's proposal with current tax law.)

CHANGES IN CORPORATE TAX LIABILITY UNDER THE TREASURY PROPOSAL*

Taxable Income	Tax under Current Law	Tax Under Treasury Proposal	Net Tax Increase (Decrease)	Percentage Change
$10,000	$1,500	$3,300	$1,800	120%
$25,000	$3,750	$8,250	$4,500	120%
$40,000	$6,450	$13,200	$6,750	105%
$50,000	$8,250	$16,500	$8,250	100%
$65,000	$12,750	$21,450	$8,700	68%
$75,000	$15,750	$24,750	$9,000	57%
$100,000	$25,750	$33,000	$7,250	28%
$125,000	$37,250	$41,250	$4,000	11%
$150,000	$48,750	$49,500	$750	2%
$200,000	$71,750	$66,000	($5,750)	(8%)

* This table assumes, for purposes of illustration, that a corporation's taxable income would not be increased or decreased by the Treasury proposal.

For a small firm with taxable income of $50,000 or less, repealing the graduated corporate tax rates would result in at least a 100 percent increase in taxes. Significant but less severe tax increases result when a firm's taxable income ranges from $50,000 to $150,000. (Again, these increases are indicated in the chart which I submit for the record.)

Since many small businesses now pay at rates below 33 percent, the maximum corporate rate set forth in the Treasury Department's proposal, we hope that this Committee and the tax-writing Committees in the House and Senate will look very closely at this aspect of any bill on this subject.

From my personal experience as a retailer, independent store owners use retained earnings as an important source of operating and expansion capital. I regard the problem of access to capital and capital accumulation as one of the most difficult barriers small retailers face in starting and expanding their business. Like other small businessmen, independent retailers do not have the ease of access to commercial loans enjoyed by larger corporations, and when they do negotiate loans, they pay interest rates substantially above the prime rate.

As this Committee is well aware, small businesses account for about 40 percent of the gross national product and two-thirds of all new employment. This entrepreneurial spirit needs to be encouraged, not stifled by Federal tax policies which run counter to the interests of the nation's small businesses. If the graduated tax is repealed, thereby forcing many small businesses to pay higher taxes, it will have a serious detrimental effect, not only on the small business, but on the economic growth of the country as a whole. For these reasons, we strongly oppose any efforts to repeal the graduated corporate tax rates.

Independent retailers are also vitally concerned about international trade, particularly in textile and apparel products. Over the last quarter century, increasingly protectionist trade policies have had an extraordinary effect on the way retailers conduct their businesses. No U.S. policy has had — or continues to have — a more profound impact on U.S. retailers and their customers than the highly protectionist policy of import quotas on textile and apparel products.

This program, which is nearly 25 years old, is sanctioned by the Multi-Fiber Arrangement (MFA) — an international agreement which allows the United States to establish bilateral quotas on imports of textile and apparel products. Today nearly

90 percent of the apparel brought into the United States comes in under a quota arrangement.

Despite this complex protectionist system, we understand that members of the Congressional Textile Caucus will be shortly introducing legislation which would roll back these quota limits, and, more important, establish a system whereby retailers and importers would have to secure a special license from the government in order to import apparel into the United States.

NRMA's smaller independent member firms believe there is no fair way to establish such a system of import licenses that would not discriminate against smaller retailers and importers. How are these licenses to be distributed? Will they be issued on historic levels of imports? That would discriminate against smaller importers and retailers who may be just breaking into the importing business, or those small firms interested in growing larger.

Will these import licenses be sold to the highest bidder? That would also discriminate against the smallest importers and retailers who do not have the monetary resources of their larger competitors.

Will these import licenses be given out on a first come first served basis? That too poses difficulties for smaller importers who would be unable to maintain Washington staff to "stand in line" for licenses, and who typically do not have the easy access to information about the potential closing of particular quotas enjoyed by the larger importers.

The result of such a regulatory scheme will be the inability of smaller retailers to offer the additional product diversity for which they are valued in the marketplace. When the merchandise assortment in smaller stores looks exactly like the merchandise available in the large department stores, chances are that smaller retailers will be in trouble. Imports are an important element in our ability to develop merchandise assortments which are distinct from our larger competitors, and which allow us to be competitive with them.

For these important business reasons, we strongly urge you to oppose this legislation when it is introduced in the next few weeks.

Unless there are questions from Committee members or staff, this concludes my statement. I want to thank the Chairman and members of the Committee for this opportunity to testify.

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*EXECUTIVE COMMITTEE

February 6, 1985

STATEMENT OF

WALTER B. STULTS

Before the

SENATE SMALL BUSINESS COMMITTEE

SUMMARY:

1. Preservation and Strengthening of SBA

2. Passage of Corporation for Small Business Investment Act (COSBI)

3. Analysis of All Pending Tax Proposals to Determine Their Impact on Small Business

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I am Walter B. Stults, President of the National Association of Small Business Investment Companies (NASBIC) which represents the overwhelming majority of all licensed SBICs and Minority Enterprise SBICs (MESBICs). Thank you for giving our Association this opportunity to express our views on the most crucial issues facing American small business today.

1. Preserving and Strengthening SBA

In common with all the other small business organizations, NASBIC gives the highest priority to countering the threat to the existence of an independent small business agency in the Executive Branch of the Government. Both as a symbol of the Federal Government's recognition of the role of small business in the American economy and as an effective provider of essential services to such firms, the Small Business Administration must be saved.

For almost 32 years, SBA has served to focus attention on public policies which would encourage the birth and growth of small business firms. Far too often, SBA's voice has proven too soft and its influence too weak to turn aside Executive Branch proposals which threatened the very existence of the independent sector of the economy. Those failures, however, call for strengthening SBA, not killing it!!

Let me give you one concrete example: The Treasury Department recently submitted its comprehensive tax "reform" package to the President. Those proposals would remove almost every incentive for capital formation and outside investment in young and growth businesses. Former Treasury Secretary Regan had the gall to make this bald statement: "The Treasury Department's proposals would allow the corporate tax rate to be reduced to 33 percent." He said "REDUCED", even though the tax rate would have been increased tremendously for the great majority of all corporations -- those earning less than $100,000 a year. If the voice of small business were louder -- or the hearing of key

Federal officials more acute, that outrageous statement would never have been made.

No one says that SBA is perfect. NASBIC believes that James Sanders has introduced a number of innovations which have materially improved the industry's operations. SBA still must administer some Congressionally-mandated programs, however, which are neither efficient nor cost-effective. On the other hand, the preferred and certified lenders programs, coupled with the newly-improved secondary market system, involve the private sector in a much more meaningful way in assisting small business and such initiatives should be supported and expanded.

The Office of the Chief Counsel for Advocacy can be effective only if it is an integral part of an independent small business agency. Even to consider burying it in the Commerce Department reveals a complete ignorance of the crucial role of that Office.

Your Committee must renounce the "numbers game" devised by the Office of Management and Budget to give legitimacy to this latest of its efforts to kill SBA. Hundreds of thousands of our most innovative and fastest-growing firms have received essential assistance from SBA programs. These are the businesses which have created almost all of the new jobs over the past two decades; these are the companies which have produced new products and services and have brought competition to the U.S. economy. While the small businesses directly utilizing SBA may number "only" in the tens of thousands annually, all American small businesses benefit indirectly from the activities and advocacy role of the Small Business Administration.

Passing COSBI

For the past three years, NASBIC and the American Association of MESBICs have devoted a major share of their talents and resources to a redesign of the SBIC program. In essence, we have been trying to take our industry completely private -- a natural step forward, we feel.

The passage of the Small Business Investment Act of 1958 marked a unique step by Congress. The Senate and the House, after several years of serious study, concluded that there was an "equity gap" which hampered the birth and growth of businesses which had enormous potentialities. Rather than setting up another Federal agency to tackle the problem, Congress turned to the private sector and entrusted the solution to privately-capitalized and privately-managed investment companies which stood to lose every dollar they committed to the enterprise.

The success of this daring action is clear. SBICs and MESBICs have effectively assisted tens of thousands of entrepreneurs at a minimum cost to the Government, while generating millions of dollars of additional tax revenues each year.

We believe the time has come to cut more of our ties to the Government; we are certain we can be even more efficient and even more effective under a new format. Last May, legislation was introduced in both the Senate and the House to establish a Corporation for Small Business Investment (COSBI) to take over SBA's current responsibilities for licensing, regulating, and providing financial assistance to SBICs and MESBICs. We hope that a refined version of the COSBI measure will be reintroduced in both bodies within the next two or three weeks with strong bipartisan support.

I shall not go further into the merits of the proposal at this time; I shall only express the strong hope that your Committee will give COSBI a high priority during this session.

3. Studying the Pending Tax Proposals

I have already more than hinted at NASBIC's reaction to the Treasury Department's tax reform package. Naturally, as long-term venture investors, we protest most strongly against the idea that the capital gains tax differential is some sort of an abusive "tax shelter" which should be eliminated. We cannot conceive why Secretary Regan bought off on this proposal. The record on capital gains taxes is dramatic!! When the rates were doubled in 1969, the venture capital industry all but died and no small businesses were able to raise funds through public offerings. When Congress refused to accept President Carter's plea to remove the differential completely in 1978 and instead cut capital gains taxes in half, the venture capital industry exploded. Billions of dollars have been invested in new and growth businesses over the past seven years by SBICs and other venture capital firms; other billions have been raised through public stock offerings. AND -- the IRS has received more dollars from capital gains taxes than it did when the rate was twice as high. Even Secretary Regan admits that removing the differential will not raise revenue -- Treasury estimates it will actually reduce receipts over the next five or six years. Why did Treasury, then, come up with this ridiculous idea? Darned if I know.

The subject of capital gains taxes is only one of the hideous ideas in the Treasury Department's opus. As I mentioned before, the Department would eliminate the graduated corporate income tax without even a by-your-leave. It claims that a 33% rate represents a reduction from the present top 46% -- not mentioning that firms earning $25,000 or less will face tax bills which are more than doubled. Treasury's magnificent benificence in permitting business deductions for the payment of dividends may be great for big businesses who pay them, but it makes not a smidgen of difference for the small and the growing firm which must hoard every penny it generates to plow back into the business for new equipment and new workers and new products. By knocking out the prospects for raising outside capital and by curtailing the retention of internally-generated dollars, the Treasury proposal is beautifully designed to bankrupt the most promising of our economic citizens.

Incidentally, other so-called "flat tax" proposals are almost equally as bad medicine for small business. We note with great approval, however, that the 1985 version of the Kemp-Kasten bill retains a capital gains tax differential, as well as a modified graduated corporate tax.

Your Committee should serve as a forum for bringing together the best ideas on taxation of smaller and growing businesses.

The Finance Committee will almost inevitably focus on the "big" picture; the Small Business Committee can produce a consensus on the needs of entrepreneurs, and small business, and outside investors in independent firms. In the past, your Committee has been effective in this role; I am certain it can be again in 1985. NASBIC will assist the members and staff of your Committee in every way possible.

Conclusion

It's going to be a busy year for all of us. In addition to the three major subject areas I carved out earlier, I did not even mention the need for passage of an authorization bill for the Small Business Administration. The lack of such legislation has brought great uncertainty to many, including the SBIC and MESBIC industries. We hope the Senate and House Committees will reach an early agreement on this important measure and get it passed.

Thank you again for this opportunity to express our views.

NADCO
National Association of Development Companies

STATEMENT
on
SMALL BUSINESS LEGISLATIVE PRIORITIES
before the
SENATE COMMITTEE ON SMALL BUSINESS
presented by
J. Martin Orr
February 6, 1985

Good morning. I am J. Martin Orr, Senior Vice President of the Kansas City Corporation for Industrial Development, and President of the National Association of Development Companies (NADCO).

NADCO was organized in 1981 to represent Certified Development Companies (CDCs) that participate in the Small Business Administration's (SBA) "503" lending program. Through this program, CDC's provide long-term, fixed asset financing to eligible small businesses. Their primary function is to stimulate growth and expansion in local communities, which, in turn creates jobs, increases the tax base, expands business ownership opportunities, and offers improved community services. This joint government/private sector program provides financing for up to 25 years for the acquisition of land, building construction, expansion, innovation, and equipment.

You have invited us to testify this morning on NADCO's legislative priorities for the 99th Congress. I am sure that it comes as no surprise that the preservation and improvement of the U.S. Small Business Administration is our first legislative priority for this and upcoming years. While we are obviously here today to promote the SBA and its 503 debenture financing program, I would like to take a moment to put NADCO's efforts and the 503 program in perspective in terms of overall small business growth and success.

NADCO members, in our local communities, offer direct financing assistance to our small business clients. We also are the front line workers for our local communities in being advocates for small businesses in general. In this role we do more than place SBA guaranteed loans behind a bank loan to improve its collateral position. We are working with our local lenders to increase their willingness to work with small businesses. And we know first-hand what a vital link SBA provides in this process.

Without the SBA, this country's small businesses would stand to lose more than a source of financing assistance; they would lose a national advocacy. Individual program efforts of SBA may be subject to criticism; however, the overall effort is essential to the nation's continued economic growth and prosperity.

The current Administration has made significant improvements in both loan default rates and program efficiency. By building a better delivery system through local banks and local development companies, the agency has increased its ability to evaluate applicant creditworthiness. At the same time, it has increased the delivery of service without increasing agency staff requirements. The preferred lender, certified lender, Small Business Investment Company and Certified Development Company programs are examples of efforts that benefit all of us - our small businesses, our local lenders and the country as a whole. This advocacy role is best carried out through actual loans to small businesses made possible by support from SBA to CDCs at the local level.

There is no question about the importance of small businesses to our national and local economies. From job creation through flexibility for innovations to providing competition in the marketplace, the role of small business has been well documented. Yet, the relationship of SBA to the universe of small businesses lately has been challenged on several grounds. Because SBA has assisted only a small percentage of all U.S. small businesses, some have dismissed its value to the small business community as a whole. We believe this approach to evaluating the agency is shortsighted, at best.

SBA, in its advocacy role, has promoted the importance of small businesses for over thirty years. Although our country has had successful small businesses since its founding, the SBA's advocacy role has been especially important from World War II to the present. During this period, technical growth has led to increased capital requirements, while at the same time, capital has become increasingly more difficult to obtain.

The historic importance of family and friends' capital investment in small businesses is not decreasing, but is facing increased competition. Family and friends have a wide variety of investment alternatives without the risk and obligation of small business commitments. Also, the availability and cost of money have become increasingly competitive in recent years. Government and large corporation borrowing is often more attractive to small lenders and banks. These lenders, therefore, may find loans to smaller businesses less desirable. Yet, small businesses, especially during growth periods, must be able to access available capital markets at a reasonable rate. SBA meets these needs -- not by making loans to marginal businesses, but by helping small, sucessful businesses grow.

The SBA Certified Development Company program exemplifies the maximum delivery of service at a minimum cost to the agency and to the taxpayer. The national network of local development companies promotes the combination of small business finance programs, performs the loan credit analysis, submits a completed application to the agency and then services the loan. The local development company places its credit and credibility on the line with the local lender and SBA. The program fills the necessary growth gap for small businesses with a successful track record - without requiring them to overcommit available funds to fixed assets when they are needed for working capital.

The SBA 503 program is especially important because it does not replace, but compliments, the private financing market. The program makes fixed cost, long term financing available for fixed asset expansion and growth by small businesses. Without the program, conventional lenders would commit for shorter periods of time at smaller percentages of a project's costs. Not only would the cost of fixed asset financing for the small business be higher, working capital would be considerably more expensive and difficult to obtain. For these reasons, the SBA 503 program has grown annually for the past three years - without an increase in agency staffings.

The SBA 503 Certified Development Company is an active public/private partnership at both local and national levels. This results in SBA and the local development companies having the best of both public support and private financing approaches. Together, SBA and the development companies are identifying ways to improve the program. Our joint track record is impressive for a number of reasons. Since the 503 program's inception in October 1980, 3,533 loans have been approved through September 1984. This represents $703.7 million of SBA 503 debentures and more than $1 billion of first mortgage loans -- resulting in 70,000 new jobs.

SBA 503 financing is more than small business financing; it is a local and national partnership for jobs and tax revenues. Through this Administration's leadership, the SBA and the 503 program have become a major economic development thrust for the United States. The strides of this SBA Administration should be supported now as the program and staff efficiencies are showing results in increased productivity and lower default rates. NADCO plans to play an active role in getting this message out to the people of this country, the public sector, and our elected officials.

Mr Chairman, I want to thank you for giving NADCO the opportunity to testify before you today. I would be happy to answer any questions you may have.

TESTIMONY OF

DAVID G. KELLY
PRESIDENT
NATIONAL ASSOCIATION OF METAL FINISHERS

BEFORE THE
SENATE COMMITTEE ON SMALL BUSINESS

FEBRUARY 6, 1985

Mr. Chairman, members of the Committee, the National Association of Metal Finishers (NAMF) appreciates this opportunity to present testimony to the Committee on Small Business addressing those issues of legislative importance to our members.

I am Dave Kelly, President of NAMF. My company, Asko Processing, Inc., is located in Seattle, Washington. NAMF represents an industry which comprises over 3,000 job shop metal finishing firms across the country. We are, in the truest sense, an industry of small business. A typical electroplating firm employs an average of 20 people and is capitalized at about $250,000. Generally speaking, our association members experience only modest returns on their investments due, in large part, to the competitiveness of our industry and to the presence of large so-called captive shops that finish their own products. If you would permit me, I would like to take a few minutes to describe our industry so you may understand the importance of our requests.

Metal finishing is a vital part of this country's manufacturing economy. Essentially, every manufactured product, ranging from automotive and aerospace goods to surgical instruments and printed circuits for computer technology, are coated. Metal finishing results in a much safer and more efficient product. It also produces tremendous economic savings for the consumer by extending the life of the products and reducing maintenance and replacement costs.

Our industry is faced with a very complicated dilemma as a result of the waste byproducts produced by the metal finishing process and associated Federal requirements. More specifically, we have been in the forefront of activities involving Federal Water Pollution Control requirements. Metal finishing is one of the first industries for which EPA has developed pretreatment standards. Those regulations which became effective in April, 1984, require electroplating job shops to have the required technology on line and operating. Our association and the members are working to comply with the standards which, based on conservative estimates by the Environmental Protection Agency, will cost our industry over one billion dollars in capital, over $490 million annually in operating expenses, and would result in the closure of about twenty percent of the metal finishing facilities in this country. Needless to say, this is a staggering economic burden for any small business sector.

More to the point, the regulations require us to remove pollutants from our wastewaters prior to discharging these waters into publicly owned treatment plants (POTWs). This results in a sludge or byproduct which must then be disposed of in a hazardous waste landfill. However, recent amendments to the Resource Conservation and Recovery Act (RCRA) will sharply curtail or prohibit the ability of NAMF members and other industries to utilize land disposal. Thus, we are forced by one set of Federal requirements to create a waste product which another set of requirements will prohibit us from disposing.

I submit that this is a rather difficult, if not impossible, problem for us to handle. Please let me point out that we do not question in any way the importance of protecting our natural resources. It is vital to the future of our country and to our industry that we do so. But, it must be accomplished in a manner that doesn't destroy the small business component of our nation's manufacturing base.

The Pollution Control Financing Guarantee Program administered by the Small Business Administration has been an important source of financial assistance for many of our members. We would urge this Committee and the Senate to take whatever action is necessary to continue the vitality and effectiveness of this program. In view of the scenario just described, I think this program becomes even more important for a wide sector of the small business community.

Unfortunately, as we all know, the funding level for many SBA programs, including financing guarantees, has been sharply reduced and/or restrictions are being placed on the eligibility of certain guarantees. This is particularly disturbing since the guarantee program does not appear to have cost the Federal government any money and in fact has enabled many businesses to continue operating and contributing to the economy. It is very difficult for me to understand how the economy is benefitted if these businesses are not able to continue operating. I do recognize the difficult budget choices faced by the Congress this year, but sincerely believe, given the magnitude and economics of this problem, that there must be some form of help offered at the national level. This does not mean that when abuses in the guarantee program exist they should not be eliminated.

However, I submit to you that solving this country's waste management problems does not represent an abuse, but rather a critical priority.

Small businesses often have a serious problem obtaining the necessary financing to cover the high cost of purchasing and operating pollution control equipment. Access to public and private markets for that type of assistance is often not available or the cost is prohibitive. SBA's Pollution Control Financing Guarantee Program has been one of the few tools our members have been able to use. While we do not have the data base to establish exact figures, we do know a significant percentage of that program's resources have gone to the metal finishing industry. It is one of the few Federal programs responsive to the needs of small business confronted with federal, state and/or local environmental regulatory requirements.

On a related topic, although not one within this Committee's jurisdiction, is the issue of liability for cleanup cost under the Superfund program. The financial exposure for small businesses in this regard is substantial, often much beyond their contribution to the overall waste load. This is not a problem unique to NAMF, but rather one which affects a significant number of small businesses in this country. Accordingly, I would urge that the Small Business Committee consider a closer examination of this problem and provide appropriate recommendations to those committees with jurisdiction over this issue. We do feel that there should be some procedures to limit the liability in a way that more fairly represents the actual contribution by individual companies.

In closing, I want to express my appreciation on behalf of the NAMF membership for this opportunity to discuss issues of major concern to our members and for your continued interest in the livelihood of this country's small business community. We often get lost in the legislative and regulatory maze facing us in Washington, DC and it is gratifying to have a forum like this committee that is designed to address our needs. Thank you again and I will be happy to answer any questions.

Statement of the Chamber of Commerce of the United States

ON: SMALL BUSINESS LEGISLATIVE PRIORITIES

TO: SENATE SMALL BUSINESS COMMITTEE

BY: FRANCES SHAINE

DATE: FEBRUARY 6, 1985

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The Chamber of Commerce of the United States is the world's largest federation of companies and associations, and is the principal spokesman for the American business community. It represents more than 180,000 companies plus several thousand other organizations such as local/state chambers of commerce and trade/professional associations.

More than 85 percent of the Chamber's members are small firms with fewer than 100 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business — manufacturing, retailing, services, construction, wholesaling, and finance — numbers more than 14,000 members. Yet, no one group constitutes as much as 26 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 50 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services, and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT

on

SMALL BUSINESS LEGISLATIVE PRIORITIES

before the

SENATE SMALL BUSINESS COMMITTEE

for the

CHAMBER OF COMMERCE OF THE UNITED STATES

by

FRANCES SHAINE

February 6, 1985

I am Frances Shaine, Chairman of the Board of the SPM Corporation, in Holyoke, Massachusetts, and a member of the Board of Directors and Council of Small Business of the United States Chamber of Commerce. With me today is Thomas E. Donley, Director of the U.S. Chamber's Small Business Center. I am pleased to have the opportunity to present the U.S. Chamber's recommendations on small business legislative priorities.

For background, let me say that I am the Chairman and Chief Executive Officer of a closely-held company in Western Massachusetts which employs about 300 people, almost 500 people at seasonal peak. We manufacture photo albums and scrap books with national distribution through mass market and department stores. In addition, we manufacture and market the Robinson Reminders line of calendars and pocket secretaries.

I am also on the Board of Visitors of the Whittemore School of Business and Economics of the University of New Hampshire, and I am a member of the Board of Directors of the Providence and Worcester Railroad, another small business.

I am well acquainted with the needs and problems of small business in a world of big business and big government. I recognize the high level of expertise of this Committee.

Nevertheless, it's important to put on the record not only those priorities of small business which we share with other business sectors, but also those issues which are specific to small business.

The United States Chamber of Commerce has an active group of small business members on the Board. Through them, and through the broad activities of the Chamber, combined forces of small business groups come together to analyze small business problems and encourage small business interests.

It is to some of those interests and problems that I speak today.

On behalf of the Chamber, I am delighted to commend this Committee for its excellent work in protecting the interests of small businesses during the 98th Congress — including, enactment of the Secondary Market legislation; White House Conference on Small Business; Small Business Procurement; Small Business Development Center; and Computer Crime legislation. Also, the Committee's many oversight activities, particularly in export finance and assistance, performed an important function in focusing the attention of policymakers on the need for expanded small business exporting and more effective service delivery by the Export-Import Bank and other federal agencies to small business exporters.

FEDERAL DEFICIT REDUCTION

We believe that the Senate Small Business Committee along with every other committee in Congress should make federal deficit reduction its top priority in 1985, through slowing the growth in federal spending.

Since 1981, federal revenues as a percentage of GNP has remained at 19 percent while federal spending has increased from 22 to almost 25 percent of GNP. The resulting budgets over the last three years have included, along with huge deficits, more than $100 billion in interest payments to finance the debt.

As the government goes into the credit markets to finance this debt, the amount of capital available for investment in housing, inventories, plant and equipment is depleted.

The U.S. Chamber has joined with six other business associations in a Deficit Reduction Coalition to present a united business position on the deficit problem. Several of the members of the Coalition, the National Federation of Independent Business, and the National Association of Wholesaler-Distributors are also testifying today.

I have included as an Appendix to my testimony a letter dated today issued by the U.S. Chamber to members of Congress presenting the Chamber's and the Coalition's recommendations to Congress.

To summarize the letter proposal, we recommend that a one-year freeze on federal spending be implemented for Fiscal Year (FY) 1986, along with other budget procedure changes.

A freeze should be comprehensive and equitable. No program would be "held harmless" or considered sacred. Spending restraint would have to occur across-the-board with all recipients and programs sharing equitably the burden of reduced funding. Administrators would be forced to make tough decisions to prioritize programs and determine where the funds are needed most.

In addition, all cost-of-living adjustments (COLAs), including those for Social Security, should be frozen for FY 86, followed by increases of less than 100 percent of the Consumer Price Index in subsequent years.

Also, the U.S. Chamber strongly urges that the federal budget decisionmaking process be improved by giving the President line item veto authority, by passing a balanced budget amendment to the Constitution, and by improving the Congressional Budget and Impoundment Control Act of 1974.

The Deficit Reduction Coalition supports the budget freeze because as a nation we must stop this hemorrage as soon as possible. Then after we have applied the tourniquet, we can decide on further cuts and improvements that need to be made.

We are in good company with this recommendation. The 1984 Small Business National Issues Conference ranked deficit reduction through spending restraint as the #1 national priority last June. The Chamber was one of five sponsors of the Conference, and we are very pleased with the consensus on legislative priorities and the teamwork that is developing among small business leaders across the country and their Washington representatives.

This process certainly will be advanced in the 1986 White House Conference on Small Business. We are concerned about the delay in preparations for the Conference, and we urge the Committee to take appropriate steps to get Conference planning started again.

GOVERNMENT COMPETITION WITH SMALL BUSINESS

I would like to discuss the Small Business National Issues Conference's second priority — reducing direct and indirect government competition with the private sector. Freedom from "government competition" also is high on the Chamber's small business priority list. Over the past several decades, government at all levels increasingly has been competing unfairly with the private sector. Governments directly compete with the private sector by producing commercially-available services and products internally. Governments compete indirectly by procuring these services and products from nonprofits organizations, universities, and regulated industries whose tax exemptions and other special preferences "immunize" them from fair competition with the taxpaying private sector.

To eliminate direct and indirect competition, Congress should enact legislation establishing as national policy that the federal government must procure commercial goods and services from the taxpaying private sector whenever feasible.

We support legislation introduced in the last session by Senator Rudman, the "Freedom From Government Competition Act," also co-sponsored by Senators Boschwitz and D'Amato, and look forward to seeing such legislation advance this session.

We oppose the many anti-contracting out amendments which recent Congress's have attached to various bills. The 98th Congress passed ten such items, which delay or deny use of the private sector to provide services to the government, while perpetuating or giving preference to services by a government work force which are readily available AT LESS COST from the private sector.

These amendments are whittling away at the free enterprise foundation on which this nation was formed, and we urge that this Committee and this Congress make a renewed effort on behalf of small business to defeat anti-contracting out amendments. Furthermore, we see the Freedom From Government Competition Act as a proactive codification of these free enterprise principles. I would mention also to the Committee members that enactment of this legislation is conservatively estimated by the Congressional

Budget Office to result in at least $1 billion per year in savings for the federal government.

SMALL BUSINESS TAX REFORM/REDUCTIONS

Since the mid-1960's, U.S. national policy has discouraged capital formation through the "triple whammy" of inflationary policies, payroll tax increases and capital gains tax increases. In tax policy, only the Capital Gains Reduction Act in 1978 and the Economic Recovery Tax Act in 1981 have slowed the trend of public redistribution of private earnings. The business community and individual taxpayers have experienced three major changes in the tax code since 1981. In 1982 and again in 1984, we have been saddled with increases and more complexity in the tax code without comparable reductions in federal government spending.

We are very concerned that Congress and the Treasury Department in trying to throw a net around tax abusers will also catch and cripple far too many law-abiding small businesses in their web of recordkeeping requirements. Specifically, we are concerned about additional limitations on seller-financed sales of realty and capital goods (known as "imputed interest"), depreciation rules for "dual use" property, and particularly, the recordkeeping requirements for automobiles, airplanes, computers, and other business equipment, tax treatment of installment sales and taxation of employee benefits.

Many members of Congress have been sensitive to these issues, and we shall continue to urge Congress and the Treasury Department to overturn the objectionable provisions. We request that this committee be prepared to hold hearings on the impact of the 1984 Tax Act if the Administration fails to move quickly to address the business community's concern.

Regarding tax simplification, we think it is vitally important and must be addressed in this Congress.

We applaud the Treasury Department's plan as a bold first step in dealing with the problem, although we are concerned about several provisions that will have a negative effect on small businesses, especially the elimination of the graduated corporate net income tax and the capital gains differential. The Chamber also has concerns about other provisions of the Tax Reform Plan which will have a negative impact on business productivity and economic growth.

I respectfully ask the Committee to hold the record open so that we might submit more detailed comments on tax simplification after our Board of Directors takes an official position on February 13. In addition, with your permission, we also would like to submit the Chamber's position on the future of the Small Business Administration at the same time.

SMALL BUSINESS ACCESS TO EQUITY CAPITAL (CAPITAL FORMATION)

In addition to reducing the growth in government spending, eliminating government competition, and instituting tax reform, I would like to emphasize the small business community's need for external sources of equity capital as another top priority The economic climate in 1983 and 1984 has allowed small businesses to prosper on the whole. Over 600,000 new corporations were formed in 1983; figures for the first half of 1984 show a 9 percent increase over 1983. Seven million four hundred thousand new jobs have been created in two years for a net increase of 6 million since the low point in the recession.

Business earnings have increased as a result of higher revenues and improved productivity. This allows small businesses to reinvest their earnings into more productive uses.

Implementing the broad reforms I described earlier will allow business development to continue. In fact, those reforms are critical to continuing our economic development. The gains of the last two years are directly linked to the tax cuts and deregulation that have taken place since 1978.

Venture capital funding and new stock offerings have exploded over the last five years financing high-tech start-ups and rapidly growing small businesses. However, this growth has been limited by geography to major financial centers and by business sectors to those businesses promising a very large return on investment.

The U.S. Chamber is concerned that established small businesses and start-up businesses seeking amounts of capital below $500,000 continue to have difficulty obtaining outside financing. Next to developing a customer base, this is the most serious impediment to small business growth. A partial solution to this problem is the "1984 Secondary Market Improvement Act." We applaud Senators Weicker and Bumpers and the committee's efforts in enacting this important legislation.

Notwithstanding, investors need more incentives to invest their money in small businesses. A number of proposals have been made to do this, mainly focusing on tax incentives and pension reform. We do not anticipate additional tax breaks or pension reform in the near future. Accordingly, we recommend a plan that is revenue-neutral and could be implemented quickly across the country.

We urge Congress to amend the federal banking laws to allow commercial banks and other financial institutions to make limited equity investments in qualifying small businesses. We are confident that banks and savings and loan institutions throughout the country, if provided an opportunity to receive a return on their investment and spur economic development in their community, would make limited equity investments in small businesses with growth potential.

This and other equity capital/capital formation proposals should be a top Congressional and Administration priority. The federal government has placed too much emphasis on providing direct loans to small businesses in the past and not enough on creating private sector incentives to do the job.

EQUAL ACCESS TO JUSTICE ACT REAUTHORIZATION

Finally, I would like to reiterate the U.S. Chamber's strong commitment to passage of a new and improved Equal Access to Justice Act to protect small businesses and individuals from government action that is not "substantially justified." We supported the legislation which was passed unanimously by Congress last October, and have been trying to persuade Administration officials to reconsider last year's veto decision. We encourage and will work toward prompt Congressional action on a bill similar to last year's that would make the law's coverage retroactive to its expiration date.

ADVANCING VOLUNTARY LEADERSHIP IN A CHANGING WORLD

Chamber of Commerce of the United States

1615 H STREET, N.W.
WASHINGTON, D.C. 20062

APPENDIX A

February 6, 1985

SENT TO ALL MEMBERS OF CONGRESS

The Honorable Gary L. Ackerman
House of Representatives
Washington, D.C. 20515

Dear Gary:

Last Friday, the U.S. Treasury released the government's outlay and revenue statement for the first quarter of the FY 1985 budget. It paints a depressing picture of our failure to come to grips with the deficit spending problem and illustrates how runaway spending is driving the deficit higher and higher. So far this fiscal year, the deficit is running $9 billion above last year's level, propelled upward by a 12 percent increase in spending. This is more than twice as fast as spending grew in the last fiscal year and several percentage points above the projected growth in the economy.

Recognizing that the continuation of such trends could lead to economic disaster, the U.S. Chamber has joined with six other major business associations to form the Deficit Reduction Coalition. Both the Chamber and the coalition, representing all facets of American business, are committed to making the deficit spending issue our top priority this year. We intend to devote substantial resources to the endeavor for as long as it takes to bring spending under control.

Working together since last April to devise a plan to reduce deficit spending, we recommend that a one year freeze on federal spending be enacted in the next fiscal year. In our view, any freeze proposal must include the following provisions:

-- All cost-of-living adjustments (COLAs), including those for social security, should be frozen in FY '86, followed by increases of less than 100 percent of CPI in subsequent years.

-- Aggregate spending for non-defense discretionary programs should be frozen at FY '85 levels for at least FY '86. Special attention should be given to potential savings from contracting out more products and services to the private sector.

-- All civilian and military pay should be frozen at FY '85 levels for FY '86. Further savings in federal pension programs can be obtained by making them more comparable to prevailing private sector practices.

-- Defense budget authority for FY '86 should be frozen at the FY '85 level followed by 4 percent per annum real growth in subsequent years. To the extent possible, such spending levels should be achieved through program stretch-out and management efficiencies.

-- Farm subsidy programs must be fundamentally reformed to achieve savings comparable to those recommended for other major programs.

-- Means-tested programs should be allowed to adjust for inflation and to accommodate new beneficiaries. However, to the extent possible, the Grace Commission recommendations to improve targeting, efficiency and management should be adopted.

The adoption and enactment of these savings proposals, as well as the many other recommendations that are now surfacing in Congress, would substantially reduce next year's deficit. The magnitude of the problem requires spending cuts of approximately $50 billion in the next fiscal year to assure that federal spending as a share of our gross national product falls during the remainder of this decade to the share it commanded when the decade began.

In the last several years, Congress and the President have worked together in a spirit of bipartisan cooperation to set a new course for public policy. That course has reversed the economic deterioration of the last decade and contributed to an economic boom that has made us the envy of the world. If we are to continue this progress and achieve rapid growth during the remainder of the decade, Congress and the President must make every effort to freeze spending in the next fiscal year.

On behalf of the Chamber's membership, I urge you to make deficit spending reduction your top priority and support an across-the-board freeze in federal spending.

Sincerely,

Richard L. Lesher

NATIONAL ASSOCIATION OF
WOMEN BUSINESS OWNERS
645 N. MICHIGAN AVE., SUITE 1058
CHICAGO, ILLINOIS 60611
312-951-9110

STATEMENT

OF

HOPE EASTMAN
NATIONAL ASSOCIATION OF WOMEN BUSINESS OWNERS

before the

Committee on Small Business
United States Senate

February 6, 1985

My name is Hope Eastman. I am a lawyer in private practice in Washington, D.C. I am a member of the Board of Directors of the National Association of Women Business Owners and am responsible for its public affairs program. We appreciate your invitation to appear here today to discuss the issues on which we believe the Committee on Small Business should focus its attention in the coming months of this Congress.

The National Association of Women Business Owners is a trade association representing more than 1800 women-owned businesses around the country. We have active chapters in 24 cities. NAWBO is affiliated with the Small Business Legislative Council, the Federation of Organizations for Professional Women, and most recently with an international group of women business owners, Les Femmes Chefs d'Entreprises Mondiales.

Women-owned businesses have only recently begun to claim significant public attention. Not until 1972 did the government report on the size and state of women-owned small businesses. Too many policy makers still perceive women-owned businesses as small, cottage industries whose contributions to the nation's economy are too small to warrant their attention.

As we shall see later in this testimony, part of this perception has been due to the government's own statistics, which in the past have dramatically understated the number of women-owned sole proprietorships and which continue to ignore the larger businesses organized in the corporate form. As one example will illustrate, the lack of Congressional and public attention has contributed to the problem. When the Census Bureau did its 1977 count of women-owned sole proprietorships, it acknowledged that it had undercounted women-owned sole proprietorships in 1972 by 1.2 million. What it did not acknowledge in its public documents was the reason for that undercount. When sole proprietorship data was gathered from the nation's tax returns, only the first name on the tax return was used. As a result, all sole proprietorships owned by married women whose husbands' names appeared first on their tax returns were not counted as women-owned businesses. More effective public scrutiny and ongoing Congressional oversight would not have permitted such a decision to go unreported and unchallenged.

The National Association of Women Business Owners believes that the time has come for strong Congressional light to be focused on the special contributions and needs of women-owned businesses. We recommend four issues for inclusion in the

Committee's agenda in this Congress.

Before turning to them, I would like to comment briefly on several issues affecting all small businesses. We support the continuation of the Small Business Administration. We believe the SBA is needed as an advocate for small business within the executive branch. We are also concerned that such a cut would destroy the proposed 1986 White House Conference on Small Business, an event mandated by Congress. There are already signs that the proposed cuts have brought Conference planning to a virtual halt.

One additional area affectng all small businesses warrants in-depth study by this Committee. Entrepreneurs are the hope of the future in economic terms, bringing growth, creativity, technological advance, and new jobs. There is considerable doubt that large companies can provide hospitable surroundings for entrepreneurship. It is becoming increasingly more difficult for new entrepreneurial businesses to find financing, whether private or public. We believe that the Congress can provide a meaningful forum for a search for ways to nurture and develop the role of the entrepreneur in our economy.

I would now like to turn to the four areas directly affectng women business owners--improving national data, access to credit, government initiatives, and procurement.

I. Improving National Data on Women Business Owners

As indicated briefly above, the National Association of Women Business Owners recommends that this Committee conduct hearings and recommend changes in current practices to insure the regular collection of reliable national data on women business owners. NAWBO also supports revision and updating of the Standard Industrial Classification (SIC) codes to reflect the dynamic changes in the services sector, including the professional and technical services, where the preponderance of women business owners is concentrated.

National Data Collection. Despite almost a decade of efforts to focus attention on the needs of women business owners, there is no total count of women-operated businesses in the United States. The State of Small Business: A Report of the President at 348 n.2 (Mar. 1984) (President's Report). Without better data on the number of women-owned firms and their gross annual receipts, a significant portion of the women-owned businesses will be invisible as public policy affecting them is shaped.

There is a prevalent belief that women-owned businesses are boutiques and small, home-based industries. The misconception that most women-owned businesses are sole proprietorships earning less than $10,000 per year, fostered by the government's own numbers, greatly interferes with the ability of the women-owned business community to focus the attention of the government and private sector on its needs, abilities, and contributions to the economy.

In both 1972 and 1977, the Bureau of the Census substantially undercounted the number of women-owned sole proprietorships in their Economic Censuses. As indicated above, federal income tax returns were the primary source of information for those reports. Business interests reported on the tax returns of married individuals were attributed to the first taxpayer on the return, usually the husband. In 1977, the Census Bureau reported approximately 700,000 women-owned sole proprietorships.[1]

In 1977, the Internal Revenue Service drew a sample of tax returns and from that sample estimated that there were approximately 1.9 million women-owned sole proprietorships, indicating that the Census Bureau figures had been off by approximately 1.2 million. Even this more complete data published by the Internal Revenue Service in 1977 and again in 1979 and 1980 may represent no more than three-fourths of the total female-operated firms. President's Report at 348 n.2.

Both Census Bureau and IRS data have not included, and there are no present plans to include, any corporations other than those which elect Sub-S status and, therefore, report the names of their shareholders on their income tax returns. A recent survey of NAWBO members indicates that a full 47 percent of the members are incorporated and do not elect Sub-S status. In addition, anecdotal evidence not limited to NAWBO members indicates the existence of large, diverse women-owned businesses which are in all likelihood incorporated and, therefore, totally outside the government's figures.

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[1] The Census Bureau also conducts the Current Population Survey, a monthly survey done for the Department of Labor's Bureau of Labor Statistics. Its questionnaire, which is directed primarily at issues of employment and unemployment, asks whether the respondent is self-employed in his or her own business, profession, or farm, and whether the business is incorporated. This data permits no detailed analysis of the business itself.

We do know from the more accurate IRS data that women-owned businesses are playing an increasingly important role in our nation's economy. Over the last decade, the number of self-employed women has grown from four to five times faster than self-employed men. Nonfarm sole proprietorships operated by women increased 33 percent from 1977 to 1980 (1.9 million to 2.5 million) while male-operated firms grew only 11 percent. President's Report at 348. Women-owned nonfarm sole proprietorships in 1980 represented 26 percent of the total. Id. at 363.

There is every reason to believe that growth has also occurred in the "invisible" segment of women-owned businesses as well. Public policy should not be made without better information on these businesses, information which we believe can be collected without an unwarranted increase in paperwork for the nation's businesses.

Standard Industrial Classifications. There is also a need for reform and updating of the Standard Industrial Classification (SIC) system in order to adequately identify the businesses into which women entrepreneurs are going.

The SIC codes were developed in the 1930s and have been updated at approximately fifteen-year intervals since that time, but only in minor ways. The agricultural and manufacturing industries, already well established in the 1930s, are represented in the SIC codes in considerable detail. The services and information sector, however, are not represented in detail despite their exponential growth over in the last several decades, particularly in the professional and technical services related to emerging technologies. Because women-owned firms are heavily concentrated in these new services, much of our entrepreneurial activity cannot be accurately recorded. Management expert, Peter Drucker, estimates that many of our national statistical indices are off 25 to 40 percent, when for effective policy making, they should be off no more than plus or minus five percent.

It is imperative that the SIC codes be revised and updated if policy makers are to have an accurate understanding of the changing nature of entrepreneurship and of the economy as it is and as it is becoming.

II. Women Business Owners' Access to Credit

The National Association of Women Business Owners urges this Committee to support initiatives to insure access of women-owned businesses to credit, including withdrawal of the current exemption of business credit transactions from provisions of the Equal Credit Opportunity Act of 1974.

A 1984 survey of NAWBO members disclosed that women business owners consider acquiring financing a major business problem. The report of President Reagan's Advisory Committee on Women Business Owners, to be released in February or March 1985, is expected to identify the same problem. Both the National Association of Women Business Owners and the Small Business

Administration's Office of Women's Business Ownership continue to receive complaints of credit discrimination.

These current reports echo earlier findings. In 1978, a presidential task force found that women seeking capital from financial institutions have faced problems "over and above those normally faced by any new or small business person" and have encountered "subtle discrimination." President's Interagency Task Force on Women Business Owners, The Bottom Line: Unequal Enterprise in America (June 1978) (President's Report). It based these findings in part on an American Management Association survey in which a majority of women believed that inability to obtain adequate financing is a significant and special problem for women business owners. President's Report at 213. Many women "found obstacles disappearing when they approached the banking environment with support or assistance from spouses, family members, or male friends, and found that borrowing had suddenly become possible.

The Equal Credit Opportunity Act of 1972, 15 U.S.C. § 1691 et seq., should have, but did not, erradicate barriers which have adversely affected the ability of women-owned businesses to secure business credit. Although the Act requires financial credit institutions to make credit available equally to all credit worthy customers without regard to sex or marital status, many of its provisions have been interpreted not to apply to business transactions.

The Federal Reserve Board was given the authority to prescribe regulations to carry out the purposes of the Act.

Their main regulation, Regulation B, amplifies the basic requirements of the Act. Regulation B prohibits a creditor from asking about an applicant's sex, race, color and national origin. It also restricts creditors from asking an applicant questions relating to birth control practices and family planning. The Act restricts a creditor's ability to seek infomation about an applicant's spouse and assures that each credit worthy individual can obtain separate credit. The Act also requires creditors to inform unsuccessful applicants of the specific reasons for an adverse action or of their right to request the reasons.

Despite the existence of these potential safeguards, the Federal Reserve Board's rules generally exempt business credit transactions from the rules requiring notification, retention of records and inquiries about marital status. These exemptions, in the context of legislative history, appear contrary to congressional intent. Commenting on the Board's power to grant exemptions from the Act, the Senate Committee on Banking, Housing and Urban Affairs wrote:

> The Board would have to make an express finding that there was no evidence or likelihood of discrimination in that class of transactions, nor would the potential for discrimination be greater if the Board were to exempt that class of transactions from compliance with one or more provisions of the Act. . . . The committee intends to indicate to the Board that it should not grant broad exemptions.

S.Rep. No. 589, 92nd Cong., 2d. Sess. 3 (1976). Similar language appears in the Conference Report on the 1976 Amendments to the Act. Conference Report S.685, 94th Cong. 2nd Sess. 9 (1976).

As has been recognized by the courts in the employment context, discrimination is often subtle and hard to detect and prove. Exempting business credit transactions from the requirements of the Act hampers the ability of enforcement agencies and women entrepreneurs to detect illegal discrimination, eliminates incentives for financial institutions to monitor their own practices, and makes it impossible for public policy makers to know whether they need to address discriminatory practices or other types of barriers to full access to credit. The rapid growth of women-owned businesses and the evidence that their problems with financing continue make action on this issue vitally important.

III. Government Initiatives for Women Business Owners

The National Association of Women Business Owners believes that Congress needs to take steps to strengthen federal government programs for women-business owners. Our first recommendation is that this Committee hold oversight hearings immediately following the release of the upcoming report of the President's Advisory Committee on Women's Business Ownership. Such hearings should cover the adequacy of existing federal government laws and programs and private sector initiatives to meet the broad needs of the women-owned small business community.

We also believe the Congress should mandate continuation of the Interagency Committee on Women's Business Enterprise, with adequate authority to marshal existing resources to provide the best possible programs for women business owners within the federal departments and agencies. The President should be required to report annually to the Congress on these activities.

In August 1977, President Jimmy Carter established an Interagency Task Force on Women Business Owners which in June 1978 presented its report, a document containing more than 200 pages of recommendations and analysis on all phases of the women's business ownership issue. President's Interagency Task Force on Women Business Owners, The Bottom Line: Unequal Enterprise in America (June 1978).

In May 1979, President Carter signed an executive order mandating affirmative action by federal departments and agencies "to facilitate, preserve and strengthen women's business enterprise and to ensure full participation by women in the free enterprise system." Executive Order 12138.

Executive Order 12138 is still in effect. In the more than five years since it was promulgated, the various departments and agencies have designated officials to be responsible for women's business ownership programs. However, the effectiveness of these programs has varied greatly. For example, in procurement, one area singled out for affirmative action in Executive Order 12138, progress has been limited. According to a recent report, more than 95 percent of procurement awards to women-owned businesses were made by only ten departments and agencies.[1] The State of Small Business: A Report of the President (Mar. 1984). Despite an increase from fiscal year 1979 to fiscal year 1982, awards to women-owned businesses were only one-half of one percent of the total award value. Developing mechanisms to increase this percent is a priority for President Reagan's Interagency Committee on Women's Business Enterprise.

Many of the intiatives undertaken to implement Executive Order 12138 have been confined to outreach inititatives, such as limited efforts to identify more women-owned businesses to bid on government contracts, as well as conferences and seminars on various issues of interest to women-owned businesses. Real change for women-owned businesses has been very small and slow in coming. There are many reasons--the glacial pace of the bureaucracy, the partial "invisibility" of women business owners due to the statistical undercount of women-owned businesses (especially the larger and more established corporations), and congressional inattention.

The Congress has held very few oversight hearings on women's business ownership issues since 1977. There has been no comprehensive examination of the specific programs and initiatives undertaken pursuant to Executive Order 12138. New congressional hearings early in 1985, to spotlight successful efforts and areas where work must be done, are badly needed.

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[1] The Department of Defense accounted for 56 percent of Fiscal Year 1982 procurement awards to women-owned businesses. Another 40 percent of the awards were made by the Departments of Agriculture, Energy, Health and Human Services, Interior, Labor and Transportation, the General Services Administration, the National Aeronautics and Space Administration, and the Veterans Administration. President's Report at 354-5.

IV. Federal Procurement for Women-Owned Small Businesses

The National Association of Women Business Owners supports the following initiatives to increase participation by women-owned small businesses in business opportunities generated by federal funds:

- Federal agencies should be required to develop policies and programs to foster increased opportunities for prime contracting and subcontracting for women-owned small businesses.
- Intermediate and large businesses should be encouraged, through incentive programs, to utilize women-owned small businesses, in joint ventures, consortia and subcontracting, to enhance procurement opportunities for women business owners.
- Executive agencies, as well as the Interagency Committee on Women's Business Enterprise, should establish advisory committees of women business owners to advise them on effective mechanisms for increasing procurement with women-owned small businesses.
- Agencies should be directed to include at least one bid from a woman-owned small business for all small purchase orders under $25,000, unless an exception is granted after inability of the contracting office to find such a woman-owned business. Documentation showing sufficient effort to find a woman-owned business capable of making an acceptable bid would be required. This "toe-in-the-door" mechanism should be tested on a trial basis for three years, and then evaluated.
- Other procurement mechanisms should be explored to increase participation of women

small business owners in federal procurement, including proposal review points awarded to women-owned small businesses.

- Financial, management, and technical assistance and support should be provided to women-owned small business as follows:
  - -- Model programs involving women-owned small businesses should be established to demonstrate effective approaches for marketing to and contracting with specific agencies (e.g., Department of Defense).
  - -- Majority women business owners should be made eligible for Minority Enterprise Small Business Investment Company (MESBIC) funding.
- The performance appraisal of government contracting employees should be related in part through the award of performance evaluation points to their success in meeting procurement goals, management assistance, and loan approvals for women-owned businesses.
- Congress should hold periodic oversight hearings on federal utilization of women-owned businesses.

For over ten years, the federal government has encouraged full participation of women-owned businesses in the procurement process, but has not provided meaningful mechanisms for the federal agencies to implement this policy. As a result, initiatives to date have been ineffective and the federal government, the largest purchaser of supplies and services in the United States, has remained essentially closed to women-owned businesses.

Procurement Achievements for Women-Owned Businesses

Fiscal Year	Dollars (in millions) Awarded to WOB	Percent of Total Gov't Procurements
1979	181.3	0.20
1980	338.4	0.37
1981	631.5	0.50
1982	683.3	0.50

Source: The State of Small Business: A Report to the President 324 (Mar. 1983).

In fiscal year 1982, more than 95 percent of all procurement awards to women-owned businesses were made by only ten departments and agencies. The State of Small Business: A Report of the President 354-5 (Mar. 1984).[1]

One commonly heard explanation for the small number of government procurement awards is the assertion that women-owned businesses are too small to compete and concentrated in goods and services the government does not need. Neither is true.

First, government statistics and reports on women-owned business have undercounted women-owned businesses, especially larger incorporated businesses, over the years. Even today, government statistics on women-owned business do not fully include businesses which operate in the corporate form. A recent

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[1] The ten departments and agencies were the Departments of Agriculture, Defense, Energy, Health and Human Services, Interior, Labor, and Transportation, the General Services Administration, the National Aeronautics and Space Administration, and the Veterans Administration.

NAWBO survey of its members indicated that 48 percent of its members were corporations, as opposed to sole proprietorships, partnerships and Sub S corporations.

Second, the government buys a vast array of products and services from outside vendors. The procurement awards which have been made to women-owned businesses attest to the diversity of these businesses--operation of government facilities, management and professional services, housekeeping, training, construction, and provision of such goods as ammunition and explosives, vehicular equipment components, furniture, and communications equipment. Id. at 353-4.

Not all women-owned businesses are small, sole proprietorships. However, virtually all of the available information on large businesses owned and operated by women is anecdotal because of the lack of statistical information available to the public. In a recent article in Savvy Magazine, a survey identified a list of the top 60 companies in the United States headed by women. "The Savvy 60," Savvy Magazine 32 (Feb. 1984). Its authors describe the informal processes by which the sixty companies were identified and the lack of reliable statistical information. Nevertheless, the article provides us with some concrete information about women-owned firms in fields where recognized procurement opportunities exist. Some of the companies were in industry: National Industries Inc. (wiring assemblies and microprocesser circuitry), Zollner Corp. (aluminum pistons and bearings), Central Pipe & Supply (tubular goods), Michigan Rivet Corp. (fasteners), and the Panhandle Producing

Company (oil and natural gas). Id. at 42. Some occupied high-tech fields: ASK Computer Systems, Inc. (turnkey computer systems), Vector Graphics Inc. (microcomputers), and Micro D, Inc. (computer products). Another cluster were in construction and related fields: North Pacific Construction (construction), Copeland Lumber Yards (retail building materials, lumber, and hardware), Sigal Development, Inc. (construction), Bach Realty, Inc. (commercial real estate), and Creative Environs of Lynn Wilson, Inc. (architectural and design firm). Id at 34-35, 39.

The Committee of 200, a national group of top women-owned businesses, created as an outgrowth of a NAWBO project to identify highly successful women business owners, provides us with another sample of such businesses. Membership in the Committee of 200 requires a women to own and have active control over a business with annual sales in excess of $5 million dollars or more. According to information supplied by the Committee on its members, a significant number of them are in business in fields in which the government does engage in procurement from the private sector. These businesses include manufacturing, general contracting, heavy construction, electronics distribution, industrial tool distribution, industrial chemical distribution, steel contracting, mapping and natural resource information, analytical chemical laboratories, petroleum refining, oil drilling supplies, metal fabrication, manufacture of products such as chemicals, institutional health care products, laboratory supplies, plumbing and lighting fixtures, and such high-tech businesses as telecommunications and computers. These businesses represent only a portion of the membership of the Committee of 200.

Women are playing an increasingly important role in the economy of the United States through the ownership of businesses. In recent years, women-owned businesses have been the fastest growing segment of the entrepreneurial community. According to government figures, women own at least 25 percent of all small businesses in the country and are going into business at a rate four to five times faster than men. Access by more of these women-owned businesses to the federal government market is crucial to their viability and to their ability to continue to contribute to the economy and to the creation of new jobs. It is in the best interests of the nation's economy to support this evolving entrepreneurial sector and to increase the resources available to the government through the use of these enterprises.

Blood From

Entrepreneurs are being forced to find ingenious ways to finance their companies

BY STEPHEN ROBINETT

On January 1, 1984, when Eric Giler, Patrick Hynes, and David Duehren quit their jobs to start Brooktrout Technologies Inc. in Wellesley, Mass., Giler made his wife a promise. If Brooktrout failed to find funding to develop its computerized voice-mail equipment within six months, he'd go back to work for someone else. "At the time," says Giler, "it seemed like it ought to be easy."

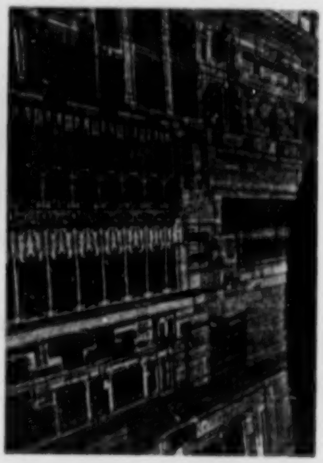
Visic Inc., founded by Joel Karp (l.) and John Reed, got production facilities and a lease line worth $30 million from corporate partners

But Giler almost missed his deadline. On June 29, only one day before time ran out, Brooktrout signed its first financing agreement, but from an unexpected source. Six individual investors in Computer Telephone Corp. (CTC), a Boston telephone equipment distributor and potential Brooktrout customer, as well as CTC itself put up financing in exchange for 28% of Brooktrout's equity. Within a month, Brooktrout had the rest of its initial financing, again in an unusual package. A private investment company guaranteed a bank loan in exchange for a 6% equity interest in the company.

Brooktrout would have had an easier time finding money just a year earlier. Money was tight in 1984. And 1985 doesn't promise much relief. Although venture capital probably finances less than 1% of all startups, it's an indicator showing the availability of all financing, an indicator currently giving entrepreneurs shivers.

"In the last four or five years, there have been about 2,500 new companies sponsored by the venture capital industry," says Neill H. Brownstein, general partner in Bessemer Venture Partners, Menlo Park, Calif. "One of the exercises we did was to figure those companies' additional total equity requirements over the next two and a half to three years. We figured those needs at $6 billion or more. The venture capital industry today has net available funds of about $2 billion—not enough to support the demand," he concludes.

What does that mean to the entrepreneur looking to raise money from a venture fund or, for that matter, from any source? If money is available at all, it takes longer to get—as investors scrutinize the deal endlessly—and it's more expensive for the entrepreneur.



That doesn't mean no one is raising money. With money tougher to get, entrepreneurs are working harder to get it. Although the deals vary widely, five big trends characterize the money hunt in this financial environment.

- Entrepreneurs are combining capital in complex packages, mixing venture capital, debt, corporate partnerships, leases, and government funds.
- More and more companies are looking for corporate partners—bigger businesses that are anxious to provide financing in exchange for technology or a product that fills a gap in their sales line, or that simply need an investment.
- Banks, often reluctant to lend to smaller compa-

A Rock

nies, are being enticed into the market with equity kickers or by outside loan packagers.

- Financing programs from government on all levels—but especially from states and cities—give entrepreneurs valuable new sources of money.
- And finally, tough times have led to the rapid development of new networks. Consultants, incubator operators, accounting and law firms, investment banks and new financial service businesses—all want to put entrepreneurs in touch with financing in exchange for a fee or a piece of the action.

What kind of deals are entrepreneurs putting together to finance their companies? Calgene Inc., Davis, Calif., a genetic engineering company, regularly turns customers into investors. Vixen Motor Co., a Pontiac, Mich., recreational vehicle maker, convinced the Detroit Policeman and Firemen Retirement System to invest. Glenn Leedy, president of American Information Systems, in Palo Alto, Calif., used a network of CPA firms to sell $2.4 million in shares in his company. Camex Inc. in Boston offered warrants to its bank in exchange for quicker access to a credit line.

Increasingly, entrepreneurs are putting together packages that combine money from venture capitalists, corporate partners, leasing firms, and commercial lenders. Two examples show the range and complexity of the deals. Akashic Memories Corp., in Santa Clara, Calif., which manufactures high-density memory coatings for computer disk drives, used an equipment lease to bridge rounds of equity financing as well as reduce the amount of equity it gave up, and then used stock warrants to eliminate a 25% to 35% cash deposit on the lease, according to Jeff Chew, Akashic's controller.

Studio Software Corp.'s second round financing came from a combination of venture capital firms, individual investors, and two corporate investors. In April, 1983 Studio easily raised $450,000 of first round venture capital backing. Six months later Studio went out for $1.5 million. "By February [of 1984] we knew we were in for a real battle," recalls Max Malone, president of Studio of Costa Mesa, Calif., a publisher of software that greatly simplifies layout procedures for large catalogs. The round closed in late July—months behind schedule—when six new investors put up $2.1 million. One quarter of that money came from Battelle Memorial Institute, the Columbus, Ohio, research lab, a potential Studio customer.

It took Brooktrout Technology founder Eric Giler (r), with co-founders David Duehren, l., and Patrick Hynes) so long to find financing he almost gave up

CORPORATE PARTNERS

Corporate partners play an increasingly important role in these packages. Some, like Battelle, are potential customers, others potential suppliers of the new company. Many hope for access to new technology or products. Vertex Peripherals, a Milpitas, Calif., disk-drive manufacturer, first negotiated a licensing agreement with the Bull Groupe, France's largest computer manufacturer. That led to a $500,000 investment by Bull. Visic Inc., a San Jose, Calif., chipmaker, got a lease-line guarantee and fabrication facilities, worth an estimated $30 million, from two corporate partners, VLSI Technology Inc., a manufacturer of custom integrated circuits, and Monolithic Memories Inc., a chip maker.

Corporate partners are looking for a product, new technology, or just an investment

Corporate investors are now much more willing to make those investments, says David Thompson, national coordinator for venture financing at Deloitte Haskins & Sells in Los Angeles. But corporate money is much more difficult to tap into than traditional venture capital, Thompson feels.

New York brokerage firm Rooney, Pace Inc. pitches a program it calls industrial investment partnership. "Companies come to us that we can't take public because of some reason—they're just too small, their managements need shoring up, they need products, or the time just isn't right," says Howard D. Sterling, group managing director of corporate finance. "Larger firms will come to us looking for an investment, and we often have to reeducate them that they don't need to have 51% to 100% of another company [to get value out of their investment]," says Sterling.

Calgene Inc., a three-year-old genetic engineering company, strives to turn its research and development customers into equity investors. "Equity creates trust, an on-going relationship, and allows more creative ways of doing business," says Rand Heer, the company's CFO. Typically, Calgene recruits corporate investors from the ranks of satisfied customers. Two of Calgene's four corporate investors are customers, each with less than a 10% equity interest in Calgene. One partner, a large French agribusiness company that Calgene declines to identify, got an "ear on technology" with its investment agreement, notes Heer. The French company has telephone rights to call up anytime and shoot the breeze about genetic engineering.

OPENING LENDERS' DOORS

Entrepreneurs too are using a wrinkle on the corporate partnership approach to arrange loans. One strategy relies on using money from some other source to convince a commercial banker it's safe to make a loan. In other cases, entrepreneurs have used consultants, incubator operators, and city officials to open lenders' doors.

Getting a loan is never easy for a new company. To obtain an unsecured loan an entrepreneur must have a good track record, often for three years or more. To get an asset-based loan, the company has to have assets, or, alternatively, what Don Cvertusa, statewide head of high-tech loan administration at Bank of America in San Francisco, calls a "handsome security deposit," normally the difference between what an entrepreneur needs and the loan the company's assets will support.

For startups at the Fulton-Carroll Center, a Chicago small business incubator [VENTURE, Nov., 1983—"What Can Incubators Offer?"], the incubator itself provides the introduction. "Most of our tenants get SBA loans for startup, but a lot are family financed corporations. We don't have a seed capital fund. We do work with nine banks in Chicago," says June Lavelle, executive director of the center.

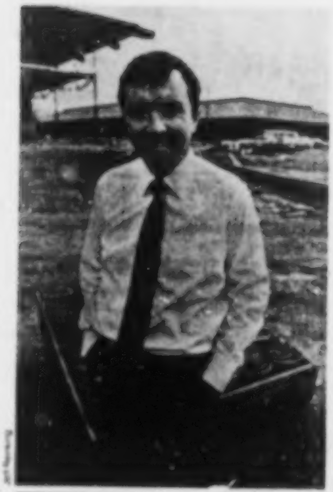
Michael Rossmeier is vice-president at American National Bank and Trust Co. of Chicago, one of the banks Lavelle works with. "Our focus is companies with from $3 million to $115 million in sales. We have contacts with attorneys, accountants, venture capitalists who bring startups to us," he says. "Our interest basically is to pick up companies that are good loan risks at that stage. We can then retain them as profitable customers as they grow from $3 million to $5 million to $20 million."

Richard Shapiro, founder and president of Charles River Data Systems Inc., keeps luring corporate investors interested in technology and new products

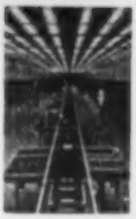
For more established companies, asset-based loans are one way a small firm can negotiate an unsecured line of credit with a large bank. Asset-based financing of small businesses with a proven track record is clearly on the rise, says Steven Diamond, chairman of the First Chicago Credit Corp. But Diamond notes that few asset-based lenders will be interested in a small loan. Community banks typically handle loans in the $100,000 range, while loans of $1 million or more are usually handled by large money center banks.

"New state programs here in Ohio have made funds available and then there're also SBA programs or the Farmers Home Administration, the Economic Development Administration, or revolving loan funds sprouting up around Ohio," says Ron James, associate director at the one-and-a-half-year-old Ohio University Innovation Center in Athens. "You can take those commitments and say to a bank, 'Look what these people will loan me if you'll come across.' We're beginning to loosen up some of the conservatism that's been a problem with some of our bankers."

Some companies have devised their own ways to loosen up their bankers. Camex Inc., a Boston manufacturer of computer-aided design and publishing systems, struck a deal with the Bank of Boston. In



The right investors can provide credibility as well as money for a fast growing company like Vertex Peripherals, says founder Jim Burke



exchange for Bank of Boston waiving loan restrictions, Camex issued the bank a five-year warrant to purchase 5,500 shares at $15 a share. Eliminating the loan restrictions helped the company nail down a $1.7 million private placement.

MONEY FROM THE STATE

"There's more public money," says Jerry Mahone, director of the small business incubator at Rensselaer Polytechnic Institute in Troy, N.Y. "I think you'll find the class startup today has some private funds, some state or local money, and traditional venture capital—a number of different sources."

Vixen Motor Co., the recreational vehicle manufacturer, tapped "every method in the book" to raise $13.3 million, according to executive vice-president Robert Dewey, who founded the company with William Collins, another former General Motors executive. First, the company raised $770,000 through the sale of limited partnerships. Then the Pontiac Economic Development Authority offered an $800,000 loan for working capital—supplemented by a $1 million loan commitment from the Michigan Economic Development Authority. Vixen also tapped the state of Michigan pension fund for a $3 million investment. Another $2 million was inverted by the Detroit Policemen and Firemen Retirement System..

Many of the state programs that fund new business are recent arrivals, born of the recession of 1980 and a growing realization that it's better to grow jobs at home than try to lure mature industries from other states. Indiana's Corporation for Innovation Development (CID), less than two years old, creates pools of capital from contributions by businesses in the state, which receive a tax write-off worth 30% of the amount invested. During 1982, the CID raised $10 million, which was augmented by the participation of private venture funds.

New Mexico, on the other hand, uses state funds. "We would have had to shut the doors and give up if NMERDI (New Mexico Energy Research and Development Institute) hadn't helped us," says Paul Vosburgh, founder of VAWT Power Inc., a Rio Rancho, N.M., windpower company. The New Mexico program is a seed capital fund with $4 million to distribute over the next three years. To date the program has funded 11 companies and normally receives 300 queries a year. "Typically, we get involved when the entrepreneur finds he needs more than he thought he would for R&D or for a prototype," says Larry Icerman, director.

Oregon and Michigan use the other major source of state investment money—public employee pension funds. The Oregon Public Employees Retirement System (OPERS) has been investing in venture limited partnerships since 1983. OPERS, which never invests directly in a company, has invested $64 million through seven venture capital pools. Michigan's Investment Division of the Bureau of Finance has put $109 million from state pension funds in venture investments. About $36 million is in direct investment, the rest in limited partnership pools.

Expanding activity at the state level comes in dramatic contrast to the current decline in federal funding for new businesses. [VENTURE, September 1984—"Has Reagan Helped or Hurt Entrepreneurs?"] The Small Business Administration's guaranteed loan program—the SBA will guarantee up to 90% of loans entrepreneurs obtain from banks, thus making it easier for small businesses to obtain loans—backed $2.6 billion in loans in 1984, down from $2.9 billion in 1980.

However, the SBA is busy expanding its secondary market in guaranteed loans under new legislation. This allows banks to bunch the guaranteed portions of SBA loans and sell them to investors, freeing more money for new loans.

At the Economic Development Administration (EDA), the total of direct loans to businesses fell to zero in 1984. Guaranteed loans may suffer the same fate. Although $150 million was authorized, no loans had been made through the third quarter of 1984. The two programs loaned $76 million and 67.5 million respectively in 1980.

PRIVATE INVESTORS

"Here in Chicago and Illinois, we're seeing more deals around and more private investment than there was last year and the year before," says Michael E. Lavin, partner in the Chicago office of accounting firm Peat, Marwick, Mitchell & Co. "Informal risk capital is immune to the ups and downs of the stock market," says William Wetzel, professor of finance at the Whittemore School of Business

St. Paul packages loans, arranges pro bono legal help, and finds angels for entrepreneurs

and Economics at the University of New Hampshire.

There's an emerging cottage industry of consultants who help entrepreneurs develop business plans and find sources of funding, says Wetzel. Lawyers, bankers, and accountants put entrepreneurs in touch with wealthy clients. Investment bankers offer a full range of services, and more of them are getting interested in startups. Such informal and formal networks as the MIT Forums, where entrepreneurs present business plans, or Wetzel's own nonprofit Venture Capital Network Inc., which uses computers to link up private investors with needy entrepreneurs in six New England states, have multiplied.

The city of St. Paul and a local law firm worked together to round up private investors for Summit Brewery. The brewery was started through an initial $25,000 investment by founder and president Mark Stutrud and his wife, Margaret VanEckhout. A $50,000 loan from the St. Paul Housing and Redevelopment Authority helped bring in the services of Coopers and Lybrand, an accounting firm, and Stolpestad, Brown, and Smith, a law firm, says Stutrud. "Soon they progressed to the point where they introduced it to their clients who became the angels," says James Terrell, an economic development specialist with the city.

That same process has been duplicated in four other deals in St. Paul. "We're a clearing house of different financing programs —real estate, debt financing, machine, equipment. We'll package SBA loans, private, conventional loans," says Alan Emory, deputy director for St. Paul's department of planning and development. "We've got relationships with accounting and advertising firms for pro bono assistance and we find angels who come up with the money."

Stolpestad, Brown and Smith is handling the private placement for Summit. According to Lori Wiese-Parks, an attorney with the firm, the offering is targeted at raising $400,000 in 40 $10,000 units, each half debt and half equity. "Our firm does go further than strictly legal work. We try to give clients connections, brokers to sell the deal, banking advice," she says.

Investment bankers are increasingly interested in entrepreneurial companies. Thoughtware Inc., a Coconut Grove, Fla., software company, met its investment banker through the Alexander Proudfoot Co., an international management consulting firm and an earlier investor. "In the second round, we were fortunate to get people who were in the investment banking business, since the market was very tight at the time," says Jack Levine, founder, president, and CEO of Thoughtware. Memphis investment bankers Morgan, Keegan & Co. Inc. found private investors for Thoughtware's second-round financing in June, 1984, a $5.5 million private placement.

Morgan is handling the placement of $2.7 in limited partnership units. Purchasers of the $100,000 units will own the product, receive a 10% royalty on gross sales, and hold 15,000 five-year warrants to purchase common stock.

Accounting firms are also putting their client lists to work. Glenn Leedy, president of American Information Systems, approached the search for well-heeled investors by contacting local financial managers—usually CPAs—who might in turn introduce him to their clients. Leedy has raised $2.4 million by selling shares in his Palo Alto, Calif., computer company to private investors. "I did it all by banging on doors in the local area." A local financial planning firm, Fish & Malley, invested and helped line up potential investors.

The financial markets have been through cycles like this before. "In April of 1973, IPOs stopped almost completely," remembers Joel Lawson, managing partner of Howard & Co., the Philadelphia publisher of *Going Public*. Money gets tight, the best sources of financing change, segments of the financial market go through readjustments. As David Thompson of Deloitte Haskins & Sells says, "The venture capital industry is alive and well and running, but it's running differently than a year or two ago." And maybe that's not such a bad thing. "Me-too" entrepreneurs get the message that easy money is no longer available and decide to stay out of the market, says Vincent Worms, a principal at Paribas Technology, the San Francicso venture capital arm of Paribas, the French bank.

Entrepreneurs offering real value will always find funding, Worms believes. But, in the current market, entrepreneurs have to look farther ahead and wider afield. "The smart entrepreneur is going to line up his latter-stage money before he even goes after the first funds," says Bessemer Partners' Brownstein, "and he's going to involve companies that will be his customers, his licensees, his distributors, etc. in helping him raise the dough." Today entrepreneurs have to look to unconventional sources, packages of debt and equity, corporate partners, state and local funds, and a growing network of potential investors. Tony La Pine, president of La Pine Technology Corp., a Santa Clara, Calif., disk-drive maker sums it up: "Money-raising is part of the job."

Additional reporting by Dave Clark, Dave Gibson, Sylvia Helm, William Logan, Sabin Russell, and Amy Salzman

DEALING FOR DOLLARS

When the going gets tough, the tough go shopping—for new sources of financing. Entrepreneurs have faced today's tight money market by stitching together complex deals using unfamiliar materials. The sampling of deals that follows illustrates five trends in current financings: (1) complex deals are blending money from many sources; (2) more entrepreneurial companies are seeking corporate partners; (3) entrepreneurs are arranging bank loans through third parties or by offering equity sweeteners; (4) government money is more available, especially at the state level; and (5) new networks are bringing entrepreneurs and private investors together.

No. 1: When no one source would do. Encore Computer Corp. wound up mixing a private placement to individual investors with debt and an equity investment by two corporate partners. Founded in May, 1983, the Wellesley Hills, Mass., company's plans to raise up to $52.2 million in a private placement with institutional investors proved too ambitious for that market. In August, 1984, the company sold $22.6 million in convertible preferred stock at $4.50 a share to the French oil services company Schlumberger Ltd., Sperry Corp., and institutional investors. Included in the package were undisclosed technology transfer agreements with Sperry and Schlumberger. The company declines to disclose what percentage of equity was sold. The balance of the $52 million Encore had originally sought is being supplied by a $30 million revolving line of credit. "We would have preferred to raise more equity, but given the market situation, we chose not to," says Encore vice-president for corporate affairs Charles Casale.

"Ya gotta shop around" might be the corporate slogan for the Megaphone Co., a one-year-old San Francisco startup that markets telephone hotlines on Michael Jackson, romance, and other topics. Banks told founders John Bremner and Kevin Monaghan they didn't have the earnings record to qualify for an unsecured loan, and a loan guarantee would have cost too much equity. For their first round, Bremner and Monaghan mounted a do-it-yourself syndication of 25 limited partnership units. Bremner, a lawyer, wrote the agreement and both men spent from December, 1983, to February, 1984, selling the units, as Monaghan puts it, "one at a time," raising over $1 million in exchange for 29% of the company's equity.

But the company still needed more capital for the $20,000 answering machines that operate Megaphone's hotlines in seven cities. This time the partners decided on a syndicated equipment leasing package put together by Meier, Mitchell, and Stanley, a San Francisco leasing company. The syndication produced a $1 million lease-line that, says Bremner, required them to give up only one-tenth as much of their company as an equivalent equity financing would have cost.

No. 2: Either find a partner or sit out the dance. Charles River Data Systems Inc., a fast-growing 12-year-old company, has been lining up corporate partners to fund the development of the company's new 32-bit computer. First, Analog Devices Inc. and Medical Information Technology Corp. invested approximately $2 million. Medical Information Technology Corp.'s massive data-entry requirments make it a potential customer for Charles River Data Systems, says Graham Briggs, financial vice-president at the computer maker. In late 1983, a new potential customer joined the ranks of investors, putting up half of a $5 million financing—SORD Computer Corp., a Japanese computer company, saw a potential to market Charles River's 32-bit machine in Japan. In the fall of 1984, Datapoint Corp. of San Antonio, Tex., a maker of local area networks, put up half of another $5 million issue. The company is a potential reseller of Charles River's new computer products as part of its own local network systems.

No. 3: You only loan to the one you love. Most companies come to the Massachusetts Technology Development Corp. when they find the amount they need ($100,000 to $250,000) is too small to interest venture firms or lenders. The state agency was designed to convince bankers to make a loan. Since it started in 1979, the corporation has leveraged about $50 million to go with its own investment in 27 companies, estimates Marie Phaneuf, public information officer. The state agency requires entrepreneurs to find a private partner, but provides its network and reputation to aid in the search. Moreover, MTDC's debt is the most subordinate in any plan.

Sometimes, even if a company can get a conventional loan, the interest rate puts the money out of reach. Educational Insights Inc. tapped into one federal loan program not specifically targeted at new businesses. In February, the Compton, Calif., maker of instructional materials and educational toys expects to close on a $2 million industrial revenue bond with 11% interest to finance construction of a new headquarters, warehouse, and assembly area. A comparable commercial loan would have cost 14.5%, says Jerry Ritt, the company's controller. Stacy Peterson, vice-president of Security Pacific Capital Markets Group, which helped the company arrange the financing, notes that the state and federal governments are tightening eligibility for industrial revenue bonds. To nail down the financing, Educational Insights had to obtain a letter of credit from Security Pacific.

No. 4: On the trail of public dollars. An Indiana state fund that raises venture money from private businesses drew International CMOS Technology Inc. (ICT) from Silicon Valley to the cornfields of the Midwest. In August, 1984, after Drew Osterman and his co-founders had left National Semiconductor Corp., ICT inked a financing deal with Hyundai Electronics America, the U.S. subsidiary of the South Korean industrial company, for 40% of the Santa Clara, Calif., firm and a technology exchange pact.

But ICT needed even more capital—and in October, 1984, ICT arranged a complex funding package that includes: $11 million in new equity funding from a group headed by the Indiana Corp. for Innovation Development (CID), a private for-profit venture capital company created by the state legislature in 1981, a $52 million lease-line guarantee from the state, and a $3 million tax abatement from the city of West Lafayette. "Our plans were to stay in Silicon Valley," says Osterman, "until we found out this package from the state was available."

No. 5: Each network starts with a single taste. Myra Evans didn't do anything very formal to raise money—she took her former colleagues at investment house Goldman Sachs in New York a taste of the gourmet Italian ice cream she wanted to sell. Through a private placement, Evans offered 49 shares of stock in Gelato Modo at $5,000 a share and within 45 days had raised the $221,000 she needed to open her first store. Evans owns 51% in sweat equity. Now in the middle of a second $450,000 private placement to begin a franchise operation, the company is offering 45 shares at $10,000 a share to current stockholders and other private investors, says Derek Jones, vice-president.

The ex-chairman of one of America's largest companies says that corporate culture leaves little room for in-house entrepreneurs

Harold Geneen: Why Intrapreneurship Doesn't Work

"Entrepreneurial Spirit," Chapter 11 from Harold Geneen's best selling book, Managing, *is subtitled "Where are the Corporate Entrepreneurs?" Geneen, the former chairman of ITT and an undisputed giant and innovator in American business, answers with no hesitation: "There are none." It is not that the man who built ITT doesn't admire entrepreneurs. He writes: "The new entrepreneurs in our midsts have emerged to become the real cutting edge of our industrial efficiency."*

But why haven't the biggest—and some say the best—corporations in America gone beyond their R&D labs to real entrepreneurial innovation? Geneen points out that large public corporations are public trusts from which investors expect 10% annual returns, and the inherent risks in entrepreneurship threaten the realization of those returns. Corporate CEOs cannot in good conscience "bet the company." Geneen also argues that employees can never be compensated at the level of owners.

Even successful entrepreneurial companies are destined to pass into corporate ranks. Concludes Geneen: "While the founder remains at the helm, he may still be allowed to . . . function like an entrepreneur. But when he and his entrepreneurial colleagues are gone and the company is listed on the New York Stock Exchange, the headstrong mavericks there will not be allowed or able to fly free."

There is an emerging awareness of the need for a return of that old American entrepreneurial spirit to lift us out of the doldrums and to make the U.S. once again the envy of the industrialized world. People are talking about various ideas to single out the entrepreneurs in corporate life and to give them free reign to "do their own thing" and to earn as much money as they deserve. Where are the Rockefellers, Carnegies, and Fords of our day? Why do our big corporations seem to be plodding along, enmeshed in a bureaucracy of their own making, caging the free spirits in their ranks with rules and regulations that stifle the bold ventures of an age gone by? Where, people ask, are our corporate entrepreneurs?

The answer is: There are none.

By definition, an entrepreneur is in business for himself; he organizes, manages, and assumes the risks of a business enterprise. In practical terms, he's the man who bets it all, takes a big risk for a big return. He's the man who puts his company on the line or, if he does not already have a company, mortgages everything he owns in order to bet that he knows something others do not.

Can you imagine a chief executive of General Electric or General Motors "betting his company" on the outcome of a single, significant move? No, a man who heads a publicly owned company is entrusted with billions of dollars that belong to others. He is cast in the role of a trustee. The people who invest their money in his company want an annual return of 10% or 12% or 15%. They don't want him to risk the assets of the company in an attempt to double or quadruple their investment. Can you imagine the lawsuits which would ensue if any such corporate "gamble" were unsuccessful? If a chief executive were foolhardy enough to take such a "calculated risk," his board of directors, out of sheer self-preservation, would not countenance it.

Some big companies try to *act* entrepreneurial in a diluted sort of way. They box off areas for experimental work, assign teams to work outside the mainstream of the company, knowing that failure would not endanger a significant part of the company. The amount of money at risk is so relatively small that the CEO's "trusteeship" is preserved, even if the venture ends in failure. Even if the venture succeeded, it would not be large enough to influence the direction of the company. However well meaning the motives, such "cells" of freedom from the bureaucracy of the corporation are little more than token entrepreneurism. In sizable corporations, an executive on his way up has to make at least five brilliant moves before he is considered on the fast track; one mistake will plant a seed of distrust that may destroy his career. Corporate managers usually need peer support for new ventures and, once their ideas are approved, they share responsibility for the new ideas with their higher-ups. The process is hardly one of going it alone. Fallback plans are worked out and held in readiness for a fast retreat. The spirit involved, far from being entrepreneurial, is to reduce the risk as much as possible. That does not mean that large corporations, with strong support systems, do not make big mistakes. They do! But those "big mistakes" are almost never the result of "big risks" taken in the hope of "big rewards." Invariably those "big mistakes" are accidents which derail the best laid plans of what had been intended to be safe, mundane ventures.

It is ironical that so many companies which started out highly entrepreneurial lost their fervor once they became investment-grade corporations. Xerox, which developed the first dry copying process, is a good example. The mystique of an inven-

From *Managing* by Harold Geneen, published by Doubleday & Co. Copyright © 1984 by Harold S. Geneen and Alvin Moscow

tive genius can preserve a company's innovative reputation in the minds of investors, bankers, and security analysts. With Polaroid, for example, investors had faith that another Dr. Land blockbuster was just around the corner. But when Dr. Land retired, much of that free, innovative spirit seemed to disappear, and several of Polaroid's key people left, seeking, as they said, more exciting climates in which to work. Polaroid fell into step with all the other companies of its size and scope.

There are exceptions, rare ones, to the rule that big corporations cannot be entrepreneurial. The most outstanding one to my mind is what Lee Iacocca did with Chrysler Corp. He did indeed "bet" the whole company on his 1983 model year, gambling that he could reorganize the company, cut the fat out of overhead and labor costs, oversee the production of a full line of new models, and sell enough Chrysler automobiles to turn a profit. Even though backed by a big government loan, it was still a big bet on his part. He was permitted to make that bet only because Chrysler appeared to have no other choice. American Motors, faced with similar circumstances, took a more conservative road. It chose to sell half its stock to Renault and to reduce its production to two models.

Shortly after I came aboard ITT in 1959, I found myself in a position to "bet the company." Cuba was the seventh country to expropriate an ITT telephone company. While it may not have been as apparent as the Chrysler situation to the public and general stockholders, we too had a difficult choice—bet now or lose later. Some 85% of our earnings were derived from overseas. Cognizant of our stockholders' concern for security, we did not make one bet; we made a series of small bets at first and then larger ones, until we had added some 350 new companies to ITT. In aggregate, we fashioned an almost entirely new company.

Beyond those first few years, however, I am not sure how "entrepreneurial" we were. Once we had

Corporations may set up independent work groups for their most creative employees, but there's still "a little thin string attached," according to Geneen

Michael Witte

If an employee is good, he's probably worth more than the company's paying him. If he succeeded on his own, he might earn 20 times more

melded our 350 acquisitions into 250 profit centers and our annual sales approached $20 billion, there was no possible way I could have called in the top management of ITT and told them to "bet" their divisions on a brand new market. These ITT managers conducted orderly businesses with orderly budgets, overseeing the work of some 350,000 employees. So, instead of risking our annual earnings in a new field of endeavor—something in the neighborhood of $500 million or later $900 million—we would give a manager $1 million or $2 million to try something "entrepreneurial." If the project failed, we would go on to something else, and still pay our expected dividend. The man who risks everything at his own business is driven by pride, fear of failure, aspirations of success, and anticipation of large rewards. It is only natural that he will out-work, out-plan, out-think the corporate manager who is drawing a salary for working for someone else.

So, the question becomes: How can a corporate structure pay a self-starting, inventive employee the rewards of an entrepreneur? The classic case is that of the star salesman. Many company presidents declare they would put no cap on how much their salesmen could make as long as they "created" new sales which benefited the entire company, that they would be happy even if one or two star salesmen earned more than the president himself. However, I have met only two chief executives who stuck to what they had said when salesmen actually did earn more than they did. The rest changed the rules. Which of them was right? Should a sales representative, no matter how good, earn more than the president? The CEO has the responsibility for the design of the product, the production and marketing, the financing and the management of the entire work involved in producing what the salesman sells. The star salesman does have a market value, which he, uniquely, can prove by the number of his sales. The designer, production chief, and marketing man would strongly resent any sales person whose compensation was out of line with their own. Still the star salesperson, it seems to me, should be paid his or her market value so that he or she does not go elsewhere to earn more money. But no more than that, unless you are willing to risk the happiness and loyalty of those others contributing to the salesman's product. So much for entrepreneurism among corporate salesmen.

Some years ago, Raytheon set up one of its brilliant research engineers as the head and *part-owner* of a company within Raytheon. The idea was to spark new products from this small, independent company of engineers. When I joined Raytheon as executive vice-president, I was called upon to umpire a bitter dispute between this independent development company and a sister division over the price of the engineer's product. The division wanted to buy the product, but thought his price exorbitant. He refused to reduce his price, saying that if Raytheon didn't want to pay that much, he could get that price from a competitor. Hostile charges and counter-charges of ingratitude marked the meeting, and no agreement could be reached. So Raytheon bought him out and he left the company. So much for the inventor-entrepreneur within corporate ranks.

Managing
by
Harold Geneen
with Alvin Moscow

Geneen writes: "Most corporate men do not want the sink or swim environment of the entrepreneur"

RISKING THE COMPANY FOR ONE RANDOM JEWEL

More recently, after I retired from ITT, I sought to find a corporate home for a small group of men who had developed a special financial service. With only a few desks, an office, and a battery of telephones, this company was already earning substantial profits. In order to double its earnings, the group wanted a home within a larger company to lend credibility to its short-term financing. The deal was that in return for upfront financing from a major corporation, the group would pay back the loan in three years, give the corporation 50% ownership in the operation, and, at the end of five years, sell its own 50% share to the corporation. The corporation would make a seven-fold capital gain.

Six different corporations agreed that the investment was desirable and that the later acquisition probably would be advantageous. But the *spectre* of introducing into the corporate ranks a handful of newcomers who would pocket millions at the end of five years was just too much to swallow. How would they explain the rewards involved to the other managers of the company, not to mention the president himself who probably would earn only 3% or 5% of that amount for running the whole company. Each decided that he would not risk his whole enterprise for one random jewel.

Corporate pay scales are delicate structures, designed to keep the workers, managers, and officers satisfied and striving for more, while the corporation itself remains profitable. The essence of corporate profitability is to keep taking in younger people, moving them up and very gradually increasing their pay. If he is good, he's probably worth more than the company is paying him. If he succeeded on his own, he might earn twice or 20 times what the company had been paying him. Some men personally prefer the safety and support of the large paternal corporation to the risk of trying to go it alone,

There cannot be entrepreneurs in corporate life. Entrepreneurs stay long enough to gain experience. Then they leave to get the cash

despite the greater rewards. The corporation also provides the recognition of working for a well-known, respected company. They offer their executives the comfort of plush offices, secretaries and staff, medical and dental plans, pension and savings plans, limousines, and bonuses. They give picnics and company dinners, and a gold watch upon retirement. Beneath it all, they also give their people the tacit assurance that their bosses won't be too tough on their performance. After all, everybody is merely working for someone else—the stockholders. They cannot be expected to work as hard as the man on the outside who is working solely for himself. He's working for the toughest boss of all.

A $50,000 BONUS FOR MILLIONS OF REVENUES

In the search for corporate entrepreneurs, some companies, especially in the high-technology lines and most especially in the young computer companies, have tried to give freer reign to their brightest people. These companies set up separate work groups and tell certain talented men to fly free—except that there will be a little thin string attached to one foot. So they become for awhile semi-entrepreneurs, but they are still working for the parent corporation which will reap the real profits of their endeavors. Nor is that totally unfair. The parent company is there to back them with financing and marketing. A smidgeon of temporary independence from the corporate bureaucracy hardly makes them real entrepreneurs. Whether you are in a cage or flying with a string on your foot does not make all that much difference.

The digital switching system, which is revolutionizing telephonic communications throughout the world, and is worth tens of millions of dollars to ITT, was based upon pulse codes invented by Dr. Alex Reeves some years ago in ITT's laboratories in England. For his brilliant innovations in telecommunications, if I remember correctly, Dr. Reeves was rewarded with a $50,000 bonus. If that sounds unfair, you must remember that Dr. Reeves was paid for doing that research. He had the comfort, support, and security of ITT behind him all the way.

After I left ITT, the company established an annual Harold S. Geneen Award for Management Creativity, and each year five or six people among ITT's current 300,000 employees are honored for their entrepreneurial endeavors with a dinner and a cash award of $5,000 to $10,000. But, like Dr. Reeves and hundreds of others, they are creative but not necessarily entrepreneurial.

Why, one might ask, do such men choose to create wealth for a large, impersonal corporation rather than try to do it alone and reap all the benefits? Many of them, as I have said, are locked into the security the corporation provides; besides, they are hardly aware of what the outside world offers. But more than that, I think, it is a matter of personality. Most corporate men are satisfied with the challenges and rewards offered in corporate life and simply do not want the sink or swim environment of the entrepreneur. They work hard enough at the office, take work home on weekends, appreciate the back-up support of having every one of their decisions approved by someone higher up.

The entrepreneurial managers I have known in corporate life were not satisfied with "inching" their way up the corporate ladder, or with the annual 5% or 10% wage increases, or with the compartmentalized nature of their assignments. They love a tough assignment. I've transferred such men to ITT divisions that were in trouble and when these men made those divisions profitable, they were rewarded with up to 20% salary and bonus increases. But that was not enough. They knew it, and I think I knew it. But ITT could not give them 30% or 50% of the increased earnings they achieved for the company. So, the true corporate entrepreneurs leave, as they always have, to start or to take over an enterprise of their own.

One of the more important things happening in our business environment today is the emerging understanding of the dilemma of how to harness the entrepreneurial spirit to the structure itself. We find increased attention to matters of morale and motivation. We find companies willing to look into new products. But the risks and rewards are not there, or only in a diluted, temporary form. Large, publicly owned corporations may devote 1% or 2% or 3% of their budget to a separate "entrepreneurial" division, but the other 99-or-so-percent of its activities will still be based upon relatively mundane growth rates of, say, 10% per year. It should be remembered, however, that 10% growth, because of the size of the large corporation, involves far, far more money, resources, and production of goods than are involved in small entrepreneurial ventures. Every shade of difference between our large corporations in morale, leadership, efficiency, innovation, and creativity is important to the growth and well-being of American industry. Perhaps the "spirit of entrepreneurism" will help point the way. But there are not and cannot be any real entrepreneurs in corporate life. Entrepreneurs stay with large companies long enough to gain experience. Then they leave to get the cash.

Small
Business
Legislative
Council

SBLC ISSUES & POLICY CONFERENCE
January 9-10, 1985
Sheraton Grand Hotel, Washington, D.C.

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STATEMENT OF

WALTER E. GALANTY, JR.

CHAIRMAN

SMALL BUSINESS LEGISLATIVE COUNCIL

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 6, 1985

> "It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise..."
>
> P.S. 85-536 as amended,
> Section 2(a), Small Business Act.

Statement of Walter E. Galanty, Jr.
before the
Senate Small Business Committee
February 6, 1985

I am Walter E. Galanty, Jr., Executive Director of the National Association of Brick Distributors headquartered in Alexandria, Virginia. I am appearing here today not only on behalf of my own association, but also in my capacity as 1985 Chairman of the Small Business Legislative Council (SBLC).

The Small Business Legislative Council is a nine year-old coalition of 88 trade and professional associations representing a combined membership of more than four million small businesses in a wide variety of industries. During the past four months SBLC has undertaken an exhaustive study of critical small business issues which concluded with a two-day Issues & Policy Conference on January 9-10. My purpose this morning is to present the results of that Conference to give you a broad overview of current small business thinking.

SBLC's issue review involved more than 100 volunteers serving on Committees in the areas of ADVOCACY, ANTITRUST, CAPITAL FORMATION & FINANCE, GOVERNMENT COMPETITION, PENSION & LABOR and TAX POLICY. We began with a list of more than 200 topics gathered from a variety of sources including the June 1984 National Issues Conference, the September 1984 Small Business Conference sponsored by the Securities and Exchange Commission and reports prepared by the Small Business Administration's Advisory Council as well as issue papers submitted by SBLC member associations.

From these original submissions our Committees selected a final list of 58 issues for full review. Policy papers covering each issue were developed and approved at the Conference. Additionally, through a formal written ballot system our members voted to rank 15 of these issues as SBLC's Top Priorities in the year ahead.

It is our intention to provide you with the complete text of all 58 issue papers as soon as the final report is prepared. This morning, however, I would like to focus my remarks on the 15 Priority Issues selected at the Conference. The complete text of each Priority Issue paper is appended to this statement. I shall simply summarize the basic points, and mention that these Priorities represent the primary work agenda for each of our Issue Committees in the year ahead.

PRIORITY NUMBER 1: PENDING TAX PROPOSALS. Public policy should be based upon incentives for entrepreneurs rather than increased tax burdens. SBLC concludes that any tax reform proposal, in addition to simplification, should recognize and maintain basic economic incentives and acknowledge the need for equitable distribution of burdens both in short-term budgeting measures and long-term tax structure.

PRIORITY NUMBER 2: ACTIVITIES OF THE SMALL BUSINESS ADMINISTRATION. For more than 30 years the SBA has stood as the sole government advocate for the small business community. SBLC strongly opposes the Administration's proposal to eliminate the SBA. It is absolutely essential that the SBA continue to represent the small business community in the executive branch of government.

PRIORITY NUMBER 3: CONTEMPORANEOUS RECORDS FOR MOTOR VEHICLES. Written contemporaneous records for verifying motor vehicle tax deductions is an additional paperwork burden that falls most heavily on the small business person who is least able to comply. SBLC is opposed to this requirement and urges its repeal by Congress.

PRIORITY NUMBER 4: NATIONAL FISCAL POLICY/FEDERAL BUDGET DEFICIT. The Federal deficit must be reduced to sustain a healthy economy. SBLC believes that all Federal expenditures, as well as tax policies, should be carefully reviewed to briing expenditures into balance with revenues. Special emphasis should be placed on entitlement and defense programs and the elimination of waste, mismanagement and inefficiency in the daily operations of government. It is essential that there be both further spending reductions and encouragement of investment and employment rather than tax increases which would discourage further growth of the economy.

PRIORITY NUMBER 5: PREDATORY PRICING. As a result of the lack of clarity in existing law, enforcement agencies have in recent years refused to charge companies with predatory pricing. SBLC supports amendments to the Clayton and Robinson-Patman Acts intended to clarify those laws and thereby remove barriers to effective enforcement.

PRIORITY NUMBER 6: TAXATION OF FRINGE BENEFITS. Members of Congress and the Administration wish to place limits on the amount of fringe benefits received by employers and employees, including employees' use of motor vehicles. SBLC opposes taxing individual employees for the imputed cost of group life and medical insurance. Employees should not be taxed in cases where they have use of a motor vehicle as a fringe benefit.

PRIORITY NUMBER 7: FULL AND OPEN COMPETITION IN FEDERAL PROCUREMENT. This concept has been reaffirmed and strengthened by the enactment of several laws in 1984. It remains to be seen, however, how well the intent of these laws will be followed in implementing regulations yet to be adopted. SBLC supports the promulgation of effective regulations to implement increases in full and open competition mandated in recent legislation. New legislation should be introduced as necessary to correct deficiencies or to address other problems.

PRIORITY NUMBER 8: EQUAL ACCESS TO JUSTICE ACT. In 1981 Congress enacted this law to permit small businesses to recover legal fees from the government if the small business prevailed in a legal action with the government, and if the government could not prove that its action was substantially justified. This Act expired in 1984. Congress passed a reauthorization bill which included several revisions and improvements, but President Reagan vetoed the bill. SBLC supports EAJA reauthorization with a provision which encompasses government liability also for the underlying action of the agency which led to formal adjudication.

PRIORITY NUMBER 9: CORPORATION FOR SMALL BUSINESS INVESTMENT (COSBI). COSBI would be a privately-owned and managed, federally chartered corporation which would act as a "capital bank" for the SBIC and MESBIC industries. This new financial intermediary between the private capital markets and the SBIC industry would replace government funding of the SBIC program with funds from the private sector. SBA's involvement in the SBIC and MESBIC programs would be terminated and replaced by a more efficient and more businesslike self-regulatory system managed by the new corporation. SBLC supports this concept and urges Congress to pass enabling legislation as quickly as possible.

PRIORITY NUMBER 10: FAIR COMPETITION. Small businesses have been threatened by increasing competition from utilities in the sales, service and installation of equipment and materials. When utilities cross-subsidize other activities or use their monopoly status to engage in other anti-competitive practices they are abusing their rate-payer supported position and are adversely affecting both competition and consumers. SBLC supports action by state government and public utility commissions to scrutinize carefully these operations, and urges the FTC and the Antitrust Division of the Department of Justice to pursue cases of monopolization of markets and anti-competitive activity which is in violation of the antitrust laws.

PRIORITY NUMBER 11: COMPETITION WITH THE PRIVATE SECTOR. Government and government preferred entities at all levels are increasingly competing unfairly with the private sector. SBLC supports Federal legislation to (1) establish a national policy of procuring goods and services from the taxpaying private sector, and (2) to control indirect competition and commercial activities to provide that preferences such as tax exemptions, postal rate discounts and contracting priorities should not be available to the commercially competitive activities of nonprofit and regulated industries.

PRIORITY NUMBER 12: WOMEN BUSINESS OWNERS' ACCESS TO CREDIT. The Equal Credit Opportunity Act of 1972 should have, but did not, eradicate barriers which have adversely affected the ability of women-owned businesses to secure business credit. Exempting business credit transactions from the requirements of the Act hampers the ability of enforcement agencies and women entrepreneurs to detect illegal discrimination. SBLC supports initiatives to insure access of women-owned businesses to credit, including withdrawal of the current exemption of business credit transactions from provisions of the Equal Credit Opportunity Act.

PRIORITY NUMBER 13: CAPITAL GAINS TAX DEFERRAL ON REINVESTMENTS IN SMALL BUSINESS. This proposal would provide an investor with a deferral of capital gains taxes when the proceeds from an otherwise taxable capital gains transaction are reinvested in a qualified small business. This is analagous to the tax treatment afforded homeowners on the sale of a residence. SBLC supports this concept and urges Congress to pass legislation amending the Tax Code to create this incentive for investment in small firms.

PRIORITY NUMBER 14: THE ROBINSON-PATMAN ACT. This 1936 law forbids price discrimination between purchasers of goods of like quality in interstate commerce where the effect of such discrimination "may be to substantially lessen competition or tend to create a monopoly in any line of commerce..." SBLC believes that the "administrative repeal" of this law must be reversed, and funds specifically for Robinson-Patman Act enforcement need to be appropriated.

PRIORITY NUMBER 15: DIRECT TAX WRITE-OFF FOR INVESTMENTS IN SMALL BUSINESS BY INDIVIDUALS. This proposal would permit individual investors to take a deduction of up to $15,000 on their tax returns ($30,000 on a joint return) for a direct cash investment in qualified stock of a small business concern, while permitting that small business to sell up to $250,000 worth of stock having this tax benefit. SBLC supports this concept and urges Congress to amend the Internal Revenue Code to create this new incentive for investment in small business.

Thank you for this opportunity to present the Priority Issues of the Small Business Legislative Council. We look forward to working closely with this Committee throughout this new session of Congress.

SBLC PRIORITY NUMBER 1

PENDING 1985 TAX PROPOSALS

ISSUE:

The small business entrepreneurial community is the mainspring of the continued vitatlity of the American economy;

- it has generated the overwhelming majority of the 18 million civilian jobs created in the past decade,
- it has consistently accounted for half of all industrial innovation,
- it constituted the prime adjustment mechanism for the U.S. in a world of increasing international competition.

This entrepreneurial community will be the first and hardest hit if budget deficits are not brought within managable limits. The performance of this group can also play a very positive role in helping to reduce the deficits by continuing to generate jobs, produce innovations, supply competition, fuel economic growth and respond to changes.

Therefore, public policy should be based upon incentives for our entrepreneuers rather than increased tax burdens. Pending tax proposals, if enacted, would stifle the very incentives that have permitted our entrepreneurs to make such progress in these areas in recent years.

RESOLUTION:

The Small Business Legislative Council concludes that any tax reform proposals, in addition to simplification, should recognize and maintain basic economic incentives and acknowledge the need for equitable distribution of burdens both in short-term budgeting measures and long-term tax structure.

SBLC PRIORITY NUMBER 2

ACTIVITIES OF THE SMALL BUSINESS ADMINISTRATION

EXPLANATION:

The Small Business Administration (SBA) was formed under a broad general mandate to protect and promote the interests of small business in the American economy. For more than 30 years, SBA has stood as the sole government advocate for the small business community.

RESOLUTION:

SBLC strongly opposes the Administration's proposal to eliminate the Small Business Administration. SBLC believes it would be a tragic mistake to kill the single agency which represents the interests of small business in the Federal government. Because small business creates the vast majority of new jobs and product innovations in the U.S. economy, pays substantial taxes to the Treasury and produces almost one-half of the nation's gross national product, it is absolutely essential that the SBA continue to represent the small business community in the executive branch of government.

The Small Business Legislative Council supports the basic mission and the continuation of the Small Business Administration. The SBA must maintain its status as an autonomous agency whose sole mission should be to advocate for and assist the small business community, with the private sector having a stronger partnership role.

To ensure that SBA's mission remains focused on areas of greatest need:

1. The independent role of the Office of Advocacy must be maintained and strengthened.

2. The Congress should mandate a comprehensive review of all SBA programs to assess their efficiency and their appropriateness to the broad needs of the small business community. That review should be conducted under the direction of the private sector, with the leadership of the small business constituency.

3. In the delivery of lending and management assistance services, SBA should be directed to increase it reliance on the local resources in the private business sector which have expertise in its program areas. SBA lending programs remain a vital resource for small business, and they must be maintained.

4. To increase small business' role in policy-making, the SBA Administrator should be a member of all Cabinet Councils affecting commerce, trade and the economy.

5. The SBA, whether through program divisions, local resources or the Office of Advocacy must expand its efforts to disseminate vital information (particularly on government regulatory efforts) to small business and provide not only management, but also technical assistance necessary for understanding and complying with such requirements.

SBLC PRIORITY NUMBER 3

MAINTENANCE OF CONTEMPORANEOUS RECORDS FOR VERIFYING MOTOR VEHICLE TAX DEDUCTIONS

BACKGROUND:

The 1984 Tax Act instituted the requirement that written contemporaneous records be maintained for the business use of motor vehicles in order to verify income tax deductions. The requirement, which began on January 1, 1985, is that the date, starting odometer reading, finishing odometer reading, and purpose of the trip be contemporaneously maintained in order to claim a deduction. This requirement is an additional paperwork burden that falls most heavily on the small business person who is least able to comply and who is most likely to feel that this provision is an onerous and undesirable one.

RESOLUTION:

The Small Business Legislative Council is opposed to the requirement that written contemporaneous records must be maintained for business use of motor vehicles in order to verify income tax deductions and urges its repeal by Congress.

SBLC PRIORITY NUMBER 4

NATIONAL FISCAL POLICY: FEDERAL BUDGET DEFICIT

BACKGROUND:

The Federal deficit must be reduced to sustain a healthy economy. Pros and cons involve whether this should be accomplished solely by reducing expenditures, or in combination with revenue (tax) increases, and who should bear the burden. Major players are the Adminstration, the Congress, the Federal Reserve and the affected interest groups.

If the Federal budget is not brought under control, high levels of government borrowing brought about by huge deficits will crowd out private sector borrowing, increase expectations of higher inflation, threaten to abort a healthy recovery, reduce jobs and household income and drive interest rates to levels which will be destructive to the economy, including its most productive sectors -- small business and agriculture. The huge deficits, if allowed to persist, will have disastrous longer-term effects by reducing the availability of funds for private investment and causing the cost of servicing the Federal debt to become an unmanageable portion of total Federal expenditures.

RESOLVED:

SBLC believes it is essential that the Administration, Congess and the Federal Reserve work together on a bipartisan basis to achieve a sustained rate of growth of the economy while holding down the rate of inflation. In this process we strongly urge that the Federal deficit be dramatically reduced and that a balanced budget be a fundamental objective. All Federal expenditures, as well as tax policies, should be carefully reviewed by the Administration and Congress to bring expenditures into balance with revenues. Special emphasis should be placed on entitlement programs, defense programs and the elimination of waste, mismanagement and inefficiency in the daily operations of government. It is essential that there be both further spending reductions and encouragement of investment and employment rather than tax increases which would discourage further growth of the economy.

SBLC PRIORITY NUMBER 5

PREDATORY PRICING

Predatory pricing is presently prohibited by Section 2 of the Sherman Act, which prohibits monopolization and attempts to monopolize, though without explicitly referring to predatory pricing. It is also prohibited by Section 3 of the Robinson-Patman Act, codified at 15 U.S.C. §13a, which prohibits firms from selling at unreasonably low prices for the purpose of destroying competition or eliminating a competitor. Section 5 of the Federal Trade Commission Act also prohibits predatory pricing where such a pricing is "unfair."

In recent years, none of these prohibitions has been enforced with vigor or effectiveness. There are numerous reasons for this lack of enforcement, but they all arise from an essential contradiction in the law. Although low prices can be an unfair weapon used against weaker competitors, low prices are also beneficial to consumers and are generally encouraged as the most important means of competition in the free market system. This contradiction is exacerbated by the fact that none of the three statutes specifically identifies the level at which competitive low prices become so low as to be injurious to competition and to the long-term interests of consumers.

As a result of the lack of clarity in existing law, enforcement agencies have in recent years refused to charge companies with predatory pricing. Where private parties have sued predators, courts have been hesitant to act, for fear of stifling legitimate pricing competition.

It is now clear that it is the vagueness of existing law that is to blame for the current ineffective enforcement of the prohibition of predatory pricing. The inability to distinguish between beneficial price competition and illegitimate predation has frozen all enforcement mechanisms into inaction.

The law should be amended by adding a prohibition to Section 2 of the Robinson-Patman Act which would clarify the prohibition in Section 3, as well as provide for private enforcement. The amendment would make several changes in existing law. First of all, it would add to the first paragraph a prohibition against selling goods "below cost where the effect may be to injure, destroy, or prevent competition." This change is necessary because courts have been extremely hesitant to determine that price is "unreasonably low," the present restriction in Section 3 of the Act. This results from a general consensus among courts, economists and lawyers that there is nothing inherently predatory about a low price. The adjective "unreasonably" merely begs the question. The price is unreasonably low if it is predatory and is not unreasonably low if it is not predatory. The real question is what makes a price predatory.

Most commentators now believe that a price is predatory if it is below cost, and legitimate competition if above cost. Any above-cost price is justifiable as a pro-competitive, consumer-benefitting price. Consequently, it is extremely rare that any court enforces the Section 3 prohibition against an unreasonably low price unless there is a showing that the price is below cost. The proposed amendment would explicitly state that a below cost price is predatory if it may injure competition. This change is not in itself sufficient to rejuvenate the prohibition against predatory pricing, because there is uncertainty in the courts as to the proper definition of cost for purposes of defining predation. Courts appear unable to resolve the competing economic theories over the proper level of costs to serve as a benchmark to measure predation. The amendment will resolve this problem by defining cost.

The second recommended change to the existing law is the addition of a definition of the term "cost" to mean "total costs, which shall include costs of producing, processing, and acquiring the product, plus allocated delivery, advertising, selling and administrative costs of doing business."

The definition of cost is the heart of the proposal. It is intended to avoid the confusion that has paralyzed the courts and enforcement agencies into inaction.

The proposed amendment would provide an effective prohibition against predatory pricing which for the first time would provide a workable definition for courts, lawyers, and businessmen to guide their pricing policies, but would nonetheless retain sufficient flexibility to permit businessmen to price their goods at levels which enhance competition.

RESOLVED:

Since vigorous enforcement of antitrust laws is essential to the well-being of small business, SBLC supports amendments to the Clayton and Robinson-Patman Acts intended to clarify provisions in those laws, and thereby remove barriers to effective enforcement. Specifically, SBLC supports efforts to clarify the distinction between legitimate and predatory pricing by defining the term "cost" to mean total cost. SBLC also supports amendments to permit injured competitors to bring private suit to enforce predatory pricing restrictions expressed in antitrust laws.

SBLC PRIORITY NUMBER 6

TAXATION OF FRINGE BENEFITS

ISSUE:

Members of Congress and the Administration wish to place limits on the amount of fringe benefits received by employers and employees, including employees' use of motor vehicles.

BACKGROUND:

The U.S. Treasury has proposed substantial tax reform. Included are proposals to tax employees' use of motor vehicles, medical expense premiums in excess of a cap and to tax all other premiums paid by an employer, including premiums for group life insurance, group accident, group legal, etc. The taxation of premiums for these coverages is certain to result in cancellation of many plans and reduction of benefits. In the case of medical life and disability insurance, the expenses that are covered by the insurance are not small and not budgetable. The insurance is not generally available to individuals, and withholdings are so complex that smaller businesses will not have the administrative facilities to operate these plans and the employees of small businesses will lose out on valuable benefits.

RESOLUTION:

The Small Business Legislative Council opposes taxing individual employees for the imputed cost of group life and medical insurance. Employees should not be taxed in cases where they have use of a motor vehicle as a fringe benefit.

SBLC PRIORITY NUMBER 7

FULL AND OPEN COMPETITION IN FEDERAL PROCUREMENT

ISSUE:

Full and open competition in federal procurement, recognized by Congress for many years as the preferred method of federal acquisition, has been reaffirmed and strengthened by the enactment of several new laws in 1984 including the Competition in Contracting Act (P.L. 98-369), the Defense Procurement Reform Act (P.L. 98-225) and the Small Business Procurement and Competition Enhancement Act (P.L. 98-577). It remains to be seen, however, how well the intent of these laws will be followed in implementing regulations yet to be adopted. These laws should not be interpreted and administered to reduce or limit small business preferences in federal prcurement programs.

BACKGROUND:

As the most economic and efficient method of procurement of goods and services, full and open competition recognizes that procurement procedures must vary depending on the nature of goods and services procured. For example, it is clear that price competition is the preferred method where all bidders offering an identical product for which precise and detailed specifications, plans, or scope have already been developed (i.e. a spare part built to the government's specifications or a contract for the maintenance of a federal building). On the other hand in cases where there is no predetermined scope or level of effort and where subjective criteria exist (including the critical need for highest or best quality) selection and ranking based on technical qualifications followed by negotiation of fair and reasonable costs is the preferable approach.

Yet over the years an increasing number of procurements of goods and services has been made on a sole source basis or with limited competition. This leads to two major disadvantages. First, the cost associated with sole source procurements is demonstrably higher than the cost associated with competitive procurements. Second, the greatest beneficiaries of sole source contracts are large prime contractors resulting in loss of competitive opportunities for small and minority businesses.

In addressing this decline in competition through the passage of the above noted measures in 1984, Congress clearly intended to increase the level of competitive opportunities for all businesses through full and open competitive procurement procedures. The practical effect of these legislative measures, however, will depend on the effectiveness of implementing regulations to be developed in 1985 and 1986.

RESOLVED:

The Small Business Legislative Council supports the promulgation of effective regulations to implement increases in full and open competition mandated in recent legislation. The implementation process should be closely monitored. New legislation should be introduced as necessary to correct deficiencies or to address other problems.

SBLC PRIORITY NUMBER 8

EQUAL ACCESS TO JUSTICE

EXPLANATION:

In 1981, Congress enacted the Equal Access to Justice Act (EAJA). The Act permitted small businesses to recover legal fees from the government if the small business prevailed in a legal action with the government, and if the government could not prove that its action was not substantially justified. The bill included a sunset provision and the law expired in 1984.

Congress passed a reauthorization bill at the end of the 98th Congress which included several revisions and improvements. President Reagan vetoed the bill.

The intent of the original legislation was to prevent the initiation of frivolous action by the government. Although the EAJA required agencies to reimburse successful small businesses, it was the belief of proponents that such expenses would and be incurred if the EAJA was a successful deterrent. Experience has validated those expectations.

At the same time, experience has uncovered several weaknesses in the original legislation. One provision of the reauthorization would provide for government liability for the development of the underlying position of the agency in small business related actions. The original legislation was limited to positions taken in formal litigation or agency proceedings. In many situations, the small business incurred significant expenses, but was not eligible for reimbursement because of the limited scope of review of the agency action. The version passed by Congress would correct that problem.

Opponents, principally agencies, have resisted such a change. They assert expanded coverage will delay or disrupt agency enforcement of their responsibilities.

STATEMENT OF POLICY:

The SBLC supports reauthorization of EAJA with a provision which encompasses government liability not only for the position taken in litigation or administrative adjudicatory proceedings, but also the underlying action of the agency which led to formal adversary adjudication.

SBLC PRIORITY NUMBER 9

1. Name of the Issue

Corporation for Small Business Investment (COSBI)

2. Brief Explanation

COSBI would be a privately-owned and managed, federally chartered corporation which would act as a "capital bank" for the SBIC and MESBIC industries. This new financial intermediary between the private capital markets and the SBIC industry would replace government funding of the SBIC program with funds from the private sector. In addition, SBA's involvement in the SBIC and MESBIC programs would be terminated and replaced by a more efficient and more businesslike self-regulatory system managed by the new corporation. Major players include Congress and the Administration (particularly Treasury, OMB and SBA).

3. Impact on Small Business

New and expanding small firms have a significant impact on our economy in terms of job creation, product innovations and generation of tax revenues. Yet, many of these small companies and start-up entrepreneurs have had difficulty securing equity capital and long-term subordinated debt from traditional sources of capital. While Small Business Investment Companies (SBICs) and Minority Enterprise Small Business Investment Companies (MESBICs) have been a very effective source of capital, their capacity to meet the equity capital needs of small business has been severely restricted by limitations of federal funding and a counter-productive system of government regulations. Establishment of this new Corporation for Small Business Investment will resolve those problems; provide a stable flow of funds to SBICs and MESBICs from private sources; create an attractive climate for significant expansion of the SBIC and MESBIC industry; and channel billions of dollars into existing, start-up and minority-owned small companies.

4. Statement of Policy

The Small Business Legislative Council supports the concept of the Corporation for Small Business Investment (COSBI) and urges Congress to pass the enabling legislation to create COSBI as quickly as possible.

SBLC PRIORITY NUMBER 10

FAIR COMPETITION

Small businesses have been threatened by increasing competition from utilities in the sales, service, and installation of equipment and materials. While we fully support fair and open competition as a basis for our free enterprise system, we are deeply concerned that the activities of the utility companies are unfair and anti-competitive.

Utility companies are large business monopolies. They are given exclusive territory to operate in, although they are regulated by state agencies, such as corporate commissions or public service commissions. Although their purpose is to supply energy via gas or electricity, they frequently enter into the business of selling, installing or servicing the equipment to use this energy. Some subsidize certain consumers at the expense of other customers to discourage fuel switching.

All of these are business areas that are well served by large numbers of small businesses. When utilities cross-subsidize other activities or use their monopoly status to engage in other anti-competitive practices, they are abusing their rate payer supported position and are adversely affecting both competition and consumers.

Certainly the problem is enhanced by the Residential Conservation Service (RCS) and the Commercial Apartment Conservation Service (CACS) which encourage greater utility involvement in these markets.

The RCS program was created by Congress in 1978 with the purpose of promoting energy conservation. It requires that utility companies conduct energy audits of homes. Although most estimates place the cost at over $100 per home, the utility is not allowed to charge more than $15. Thus, the utility is required to cross-subsidize these from other rate paying consumers. Small businesses that provide this service are unable to compete. Even more damaging, the program gives utilities greater access to the market to promote their own merchandising activities over that of small business.

The CACS was created by Congress in 1980 to provide RCS type activities to multi-family residences and to small commercial establishments. It poses even greater risk of further utility monopoly intrusion into the marketplace.

In the guise of promoting the consumer interest, such utility practices promote greater consumer injury, particularly in a period of high energy costs. While certainly some customers may benefit from these programs, there are far many more consumers who are subsidizing them through the rate base. These consumers include are the poor, senior citizens, and others on fixed income who can ill afford current energy prices, let alone paying more to help utilities to expand their monopoly over the market.

The small businesses affected are labor intensive industries. For example, the contractors that are injured are locally based in cities and towns throughout the country. The jobs which utilities eliminate by unfair competition adversely affect such free enterprise, highly competitive entrepreneurs.

The problem with unfair competition from utilities reaches a variety of contractor is retail groups, and are also of deep concern to supplier and manufacturing groups. Certainly, it is time to reexamine the role of utilities as publicly regulated monopolies and their impact on free enterprise highly competitive businesses.

RESOLVED:

The Small Business Legislative Council supports action by state government and public utility commissions to scrutinize carefully the operations of large business utilities and to prevent unfair or anti-competitive impact on small businesses.

SBLC urges the Federal Trade Commission and the Antitrust Division of the Justice Department to pursue cases of monopolization of markets and anti-competitive activity which is in violation of the antitrust laws.

Congress should conduct hearings on the practices of large business utilities and on the effect of their activities on small businesses to determine the proper role of utilities. Legislation should be developed which provides that utilities will not be permitted to use their monopoly market position to compete unfairly.

While SBLC supports energy conservation, the Residential Conservation Service (RCS) and Commercial and Apartment Conservation Service (CACS) should not provide utilities with unfair market advantage. Either the programs should be eliminated or revised to protect against unfair competition.

In addition, any changes to the Public Utility Holding Company Act should not make it easier for public utilities to diversify into consumer related products and services.

SBLC PRIORITY NUMBER 11

COMPETITION WITH THE PRIVATE SECTOR

ISSUE:

Government and government preferred entities at all levels are increasingly competing unfairly with the private sector. They compete directly with the private sector by producing commercially available services and products for themselves, and indirectly by procuring these items and services from nonprofits, universities, federally funded research and development centers and regulated industries whose exemptions and other economic preferences immunize them from fair and effective competition.

This unfair competition removes a major market from the private sector's reach, a market that under fair competitive conditions the private sector would ultimately serve more efficiently than subsidized and protected sources or the government itself. Government, nonprofits and regulated industries should devote their resources to their intended functions. Organizations receiving the benefits of government subsidization should be concentrating on those activities for which those incentives were created rather than divert critical resources to commercial activities.

A policy of reliance on the private sector will ensure greater productivity, enhance the job creation process and result in substantial savings.

RESOLUTION:

To minimize direct competition the Small Business Legislative Council supports Federal legislation to (1) establish a national policy of procuring commercial goods and services from the taxpaying private sector, (2) to control indirect competition and commercial activities so as to provide that preferences such as tax exemptions, postal rate discounts and contracting priorities not be available to the commercially competitive activities of nonprofit and regulated industries. These policies should be extended to the state and local governments and federally funded research and development centers through appropriate regulation and further guidelines applicable to the expenditure of federal funds.

SBLC PRIORITY NUMBER 12

WOMEN BUSINESS OWNERS' ACCESS TO CREDIT

EXPLANATION:

A 1984 survey of NAWBO members disclosed that women business owners consider acquiring financing a major business problem. The report of President Reagan's Advisory Committee on Women Business Owners, to be released in January 1985, is expected to identify the same problem. Both the National Association of Women Business Owners and the SBA's Office of Women's Business Ownership continue to receive complaints of credit discrimination.

These current reports echo earlier findings. In 1978, a Presidential task force found that women seeking capital from financial institutions have faced problems "over and above those normally faced by any new or small business person" and have encountered "subtle discrimination." It based these findings in part on an American Management Association survey in which a majority of women believed that inability to obtain adequate financing is a significant and special problem for women business owners. Many women "found obstacles disappearing when they approached the banking environment with support or assistance from spouses, family members or male friends, and found that borrowing had suddenly become possible."

The Equal Credit Opportunity Act of 1972 should have, but did not, erradicate barriers which have adversely affected the ability of women-owned businesses to secure business credit. Although the Act requires financial credit institutions to make credit available to all credit worthy customers without regard to sex or marital status, many of its provisions have been interpreted not to apply to business transactions.

The Federal Reserve Board was given the authority to prescribe regulations to carry out the purposes of the Act. Their main regulation, Regulation B, amplifies the basic requirements of the Act. Regulation B prohibits a creditor from asking about an applicant's sex, race, color and national origin. It also restricts creditors from asking an applicant questions relating to birth control practices and family planning. The Act restricts a creditor's ability to seek information about an applicant's spouse and assures that each credit worthy individual can obtain separate credit. The Act also requires creditors to inform unsuccessful applicants of the specific reasons for an adverse action or of their right to request the reasons.

Despite the existence of these potential safeguards, the FRB's rules generally exempt business credit transactions from the rules requiring notification, retention of records and inquiries about marital status. These exemptions, in the context of legislative history, appear contrary to congressional intent. Commenting on the Board's power to grant exemptions from the Act, the Senate Committee on Banking, Housing & Urban Afffairs wrote in 1976:

SBLC PRIORITY NUMBER 12 CONTINUED

> "The Board would have to make an express finding that there was no evidence or likelihood of discrimination in that class of transactions, nor would the potential for discrimination be greater if the Board were to exempt that class of transactions from compliance with one or more provisions of the Act. . . The Committee intends to indicate to the Board that it should not grand broad exemptions."

As has been recognized by the courts in the employment context, discrimination is often subtle and hard to detect and prove. Exempting business credit transactions from the requirements of the Act hampers the ability of enforcement agencies and women entrepreneurs to detect illegal discrimination, eliminates incentives for financial institutions to monitor their own practices, and makes it impossible for public policy makers to know whether they need to address discriminatory practices or other types of barriers to full access to credit. The rapid growth of women-owned businesses and the evidence that their problems with financing continue to make action on this issue vitally important.

RESOLUTION:

The Small Business Legislative Council supports initiatives to insure access of women-owned businesses to credit, including withdrawal of the current exemption of business credit transactions from provisions of the Equal Credit Opportunity Act.

SBLC PRIORITY NUMBER 13

1. Name of the Issue

Capital Gains Tax Deferral on Reinvestments in Small Business. (Sometimes referred to as the Small Business Capital Gains "Rollover")

2. Brief Explanation

This proposed tax change would provide an investor with a deferral of capital gains taxes when the proceeds from an otherwise taxable capital gains transaction are reinvested in a qualified small business. The proposal is analagous to the tax treatment afforded homeowners on the sale of a residence. The pro is that this proposal would encourage investors to move funds into small business investments. Possible cons include that it runs counter to current Treasury tax proposals; potential revenue loss is unknown; and without proper safeguards it could be subject to tax avoidance abuse.

3. Impact on Small Business

Lack of access to long-term capital remains a major concern for small business owners who are unable to attract financing for expansion. While new companies generally obtain risk capital from personal savings or investments from family, friends or business associates, the need for investment and reinvestment in small firms for new machinery, modernization and growth is an increasingly critical priority. At the same time, current tax laws provide incentives for the flight of capital from small to big business. Many investors with unrealized appreciation in a small business will seek to realize that gain by disposing of the investment through a tax free merger or stock-swap which is a nonproductive reallocation of capital to larger companies.

A realistic method of persuading investors to accept the risk of investing in small business is to provide an incentive which will reward risk taking with an immediate deferral of current tax liability. The small business capital gains tax "rollover" would defer the investor's capital gains taxes when the proceeds from another capital asset sale are invested in a qualified small business. This proposal would encourage investors who have "locked-in" investments to move some of these funds into small businesses; it would make it attractive for investors who sell their small business portfolios to reinvest the proceeds in other qualifying small firms; and it would significantly reduce the tax code's artificial bias toward small company combinations with larger companies.

4. Statement of Policy

The Small Business Legislative Council supports the concept of a Capital Gains Tax Deferral on Reinvestments in Small Business and urges Congress to pass legislation amending the Tax Code to create this incentive for investment in small firms.

SBLC PRIORITY NUMBER 14

THE ROBINSON-PATMAN ACT

Antitrust law has a single stated goal: preservation of competition. That goal motivated the U.S. Congress to enact the Sherman Antitrust Act in 1890. The Sherman Act, though, could provide penalties only in those instances in which offenses had already taken place. The 63rd Congress strengthened existing antitrust law with passage of the Clayton Act. The basic intent of the Clayton Act was to prevent monopolies from being formed through the use of unfair, anti-competitive trade practices.

The Clayton Act, however, proved to be ineffective against price discrimination, partially by reason of inadequate enforcement and partially due to judicial interpretation. Under the interpretation of the Clayton Act, there was no mechanism to prevent the stifling of competition through the granting of excessively favorable pricing for items purchased by large buyers.

To remedy this, the Congress, in 1936, overwhelmingly approved the Robinson-Patman Act, which has come to be known as the "Magna Carta" of small business. The Robinson-Patman Act forbids price discrimination between purchasers of goods of like quality in interstate commerce, where the effect of such discrimination "may be to substantially lessen competition or tend to create a monopoly in any line of commerce..."

A jurisdictional requirement of the Robinson-Patman Act allows action under the Act only where the price discrimination may lessen competition or tend to create a monopoly. This essential clause clearly points out that the Act, as originally framed, was created to promote competition, and to discourage increased concentration.

The Robinson-Patman Act does not "reward inefficiency," as its critics claim, but does prevent rewarding the largest buyers in the market simply because of their size. Large buyers may claim a purchasing advantage, but this must be based on the cost-justified volume of their purchases.

RESOLVED:

To assist the small business, the Robinson-Patman Act was enacted to stop in the incipiency anti-competitive practices which have plagued this country. The Robinson-Patman Act is a cornerstone which small business stands behind, and any effort to erode its principles is opposed, since this would lead to a weakening of the segment of our society which has built this country. The "administrative repeal" **of the Robinson-Patman Act must be reversed, and funds specifically for Robinson-Patman Act enforcement need to be appropriated. The FTC must be required to show the effects of its enforcement of "The Magna Carta of small business."**

SBLC PRIORITY NUMBER 15

1. Name of the Issue

Direct Tax Write-Off for Investments in Small Business by Individuals

2. Brief Explanation

This proposal would permit individual investors to take a deduction of up to $15,000 on their tax returns ($30,000 on a joint return) for a direct cash investment in qualified stock of a small business concern; while permitting that small business to sell up to $250,000 worth of stock having this tax benefit. Creation of this new tax deduction would require an amendment to the Tax Code. Such a bill (H.R. 1444) was introduced in the 98th Congress, but no action was taken. The Joint Committee on Taxation has estimated this legislation would cause a revenue loss to the Treasury of $50 million the first year and $100 million in each of the next four years. Major players are the Administration (Treasury) and Congress (the tax-writing Committees).

3. Impact on Small Business

Most small business people today do not have access to financing vehicles such as public sale of equity securities, the issuance of bonds or venture capital markets. Most of the capital available for small business comes from personal savings, friends, relatives and business associates. An investment in small business is generally considered a high risk venture, thus many individuals with available capital are discouraged from investing in small firms and place their funds in more attractive (but often less productive) investment alternatives. This situation is compounded by present tax laws which help make investments in small firms less attractive, including double taxation of corporate dividends, capital loss limitations on the sale of stock and the treatment of loans to small business as nonbusiness loans.

This proposal is designed to overcome these problems by making it economically attractive for individual investors to invest in the millions of smaller independent business concerns that do not have access to institutional sources of investment capital.

4. Statement of Policy

The Small Business Legislative Council supports the concept of Direct Write-Offs for Investments in Small Business by Individuals and urges Congress to amend the Internal Revenue Code to create this new incentive for investment in small business.

SBLC PRIORITY NUMBER 15 CONTINUED

The following qualifications and safeguards , or variations thereof, could be included in the proposal to assure use by the intended range of small firms and to prevent abuse:

- A small company may only sell $250,000 worth of stock qualified for the tax deduction.

- The tax deduction is limited to $15,000 per person per year ($30,000 on a joint return).

- The investment must be in cash only and the funds must go directly to the small company.

- The individual who purchases stock under the plan shall not be entitled to either dividends or a return of capital for a period of 3 years from the date which the stock was purchased.

- Sale of securities purchased under the plan is permissible but not to an existing shareholder of the company for 3 years from the date of purchase.

- Upon disposition of stock purchased under the plan, gains realized to the extent of previous write-offs will be taxed at ordinary income rates, while all additional gains will be taxed at capital gains rates.

- The selling company must be actively engaged in a trade or business and the funds must be used in the conduct of that trade or business. This is to assure that passive corporations are not used to abuse the law and to avoid tax shelter schemes.

- The investor may not, after purchase of stock under the plan, own more than fifty percent of the small company's stock.

- An existing owner of a company may not purchase stock under the plan unless his ownership position is solely because of a previous purchase of stock under the plan. The purpose of the plan is not to give existing business owners a tax benefit for putting their funds into the business.

- Any reciprocal agreements between purchasers or third parties to cross-purchase stock in small firms will void the tax deduction.

- Companies which are members of a control group will be treated as a single corporation.

- Personal service corporations are prohibited from qualifying under the plan.

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TESTIMONY OF
JOHN S. SATAGAJ
OF AMERICAN ASSOCIATION OF NURSERYMEN
BEFORE THE
U.S. SENATE COMMITTEE ON SMALL BUSINESSS
ON FEBRUARY 6, 1985

Thank you for this opportunity to participate in the development of a small business issue agenda for the 99th Congress. The American Association of Nurserymen (AAN) represents over 3,000 firms in the nursery industry, nearly all small business, including growers, garden centers and landscape firms.

First and foremost, we believe this Committee should continue to play an active role in the development of all legislation which will have impact upon small business. We cannot emphasize enough the importance of your leadership in small business matters, not only within the jurisdictional bounds of the Small Business Act, but also in matters before such committees as the Committee on Finance.

Tax Matters

The subject of tax reform is a source of great concern to us. We believe the current tax code is confusing, complex and creates enormous compliance problems for the average small businessman. For this reason, we are supportive of efforts to simplify the current tax system. At the same time, however, we believe the tax code plays a fundamental role in encouraging the birth, growth and expansion of small business. Given our proven performance in job creation, innovation and competition, the code should continue to provide economic incentives which achieve these ends. Also, we have found that tax "reforms", while looking good on paper, frequently overlook the realities of the business world. We know of at least one instance in the Treasury proposal where such is the case with regard to our industry.

We believe there is ample room to fashion a plan which will capture the essence of simplification and also encourage economic growth through small business. For example, we are not advocating elimination of ACRS, but we do recognize that while the 1981 ACRS system might have been right for those inflation burdened times, alternatives, such as expensing, which achieve similar results without the inflation-fighting features of ACRS, may be more effective in the long run, and not so costly in terms of lost tax revenues. Likewise, deductibility of dividends is not a major concern for most small firms. Cuts in personal rates will be a major help to sole proprietorships and existing S Corporations, although encouragement of S Corporations may be contrary to a long term growth policy. At a minimum, a modified graduated corporate tax rate, perhaps structured along the lines of Treasury's proposed personal rate structure, is necessary.

There are several areas of the tax code which, under ideal conditions, can stimulate further activity by small business. Accumulated earnings are a prime source of capital for existing businesses. For that reason, S Corporations are not the best vehicle for a growth oriented company. We may have to take a closer look at corporate form and tax policy. We should encourage efforts to allow small business to make more efficient use of earnings. There was a proposal before the 98th Congress, and we are confident it will be placed before the 99th, which will permit and encourage small business to use retained earnings, and to tap that supply of capital. Likewise, we remain convinced a broad job tax credit will work and will produce the job creation efforts which will help small business, the economy and our nation. The limited credit is due to expire, and we hope the committee will participate in efforts to retain and expand the credit.

Tax compliance matters are very much on the minds of our members. The establishment of new criteria for the tax treatment of personal property, specifically vehicles, has already created enormous burdens for our members. Whether it is a grower transporting products to the market, a salesman traveling to a sales call or a landscape firm transporting products and employees to a job site, our industry is "transportation intensive" in proportion to the size of the typical firm. The number of vehicles can range from one or two to a fleet of hundreds. Our "on the road" vehicles come in all manner of shapes and sizes, from cars to pick-ups to trucks, as well as airplanes. All of these vehicles would appear to fall within the definition of vehicle for the purposes of record keeping. We are particularly concerned about this all-encompassing definition as we believe it certainly exceeds the intent of the law.

Frequently, the same vehicle will be operated by a substantial number of employees for a variety of business trips. In a typical day a vehicle may be used for a dozen different trips by three or four employees. This multiple operator/multiple trip use will create additional administrative burdens and will cost our firms more in compliance hours than the "value" of the deductions for which such vehicles are eligible.

IRS recently announced revisions to the proposed regulations constitute progress, but these changes leave many questions unanswered. We believe a return to the pre-1985 situation is in order as the IRS is limited as to what it can or cannot do under the law. While the revisions may alleviate short term tensions, the law remains on the books. Our small businesses cannot understand why the government creates such complex rules to extract such a modest amount of revenue.

Now, the other shoe has dropped, and the IRS has issued cumbersome rules for the valuation of the personal use of the vehicle as a taxable fringe benefit to the employee.

Given the nature of our business, fringe benefits remain the exception rather than the rule. The use of a vehicle is one of the few fringes available to an owner to offer to the crew boss or other key employees. Even with the IRS changes to the business use rule, it seems there will almost always be some portion, after the working condition fringe benefit calculation is applied, which will continue to be taxable to the employee. While we are by no means challenging the concept of fringe benefit taxation, we do feel the Congress should be cognizant of what it has wrought. It is difficult for us to explain what this means to employer/employee relations, but it creates more misunderstanding and aggravation than what it is worth when the value starts appearing on W-2s.

Another compliance problem is the requirement that a recipient firm must report the receipt of more than $600 worth of services from an individual. The typical firm deals with many vendors and this requirement has created a barrage of paperwork. It is not necessary for the recipient firm to collect information from corporations under the law, yet the system is set up in such a way that there is no simple means for a recipient firm to separate the "chaff from the wheat". The result is a blizzard of paperwork. The recipient mails a request to every supplier to cover the bases. This makes no sense. To our members, it seems the government is increasing paperwork instead of eliminating it. We call this to the attention to the Committee to stress the need for a strong paperwork reduction program. We're losing ground instead of gaining on the problem.

Finally in the tax area, the so called payroll "taxes", such as social security and unemployment compensation, continue to plague most existing businesses. We cannot continue to burden labor intensive firms in sensitive cash flow areas.

Small Business Administration

We are very concerned about the future of the U.S. Small Business Administration. We believe the debate transcends the dollars and cents of budget savings. We are prepared to accept across the board cuts in SBA programs, but we strongly advocate the maintenance of an independent agency.

We hasten to say we have no quarrel with the desire of OMB to review specific programs of the SBA and to, perhaps, terminate some of them. We are concerned, however, that we ensure the "elimination" debate includes the much broader picture of the role of the Small Business Administration in national policy decisions. In the case of the SBA, the whole may be greater than the sum of the parts. What it represents as a national forum cannot be lost in the shuffle of examining the quality of the programs it administers. The SBA administers a variety of programs, such as financial, procurement, management and disaster assistance. There are strong arguments to be made against several of these programs. In a time when government efficiency is a major concern, the SBA family of programs leaves something to be desired.

However, the elimination of the agency has major ramifications for small businesses which have nothing to do with these individual programs. In some respects, it is the "domino" effect. The Congressional Small Business Committees have legislative authority over the SBA. Stripped of that authority, is it only a matter of time before opponents challenge the validity of the committees? The list of recent successful legislative efforts in behalf of small business is due in part to the ability of these committees to build on their specific legislative authority to participate in broad policy debates. The last time the committees came under scrutiny, these considerations were important to the reaffirmation of their role. What assurances do we have that the committees will be allowed a role in future matters?

What about the many very small struggling businesses which cannot join the "generic" organizations or national trade associations? Certainly, the associations have attempted, and will continue, to represent their interests, but I don't think anyone in the community of small business advocates would claim they could do it without the SBA or the Congressional Committees. Laws like the Regulatory Flexibility Act, the Equal Access to Justice Act or procurement legislation, are frequently only as good as their oversight. Who will conduct such monitoring and oversight? Both the SBA and the committees play roles in this process at the present time.

Make no mistake about it, since the creation of the Office of Advocacy, the entire SBA has emerged as focal point, and forum, for many small businesses not otherwise represented within our system. In 1985-86 we are looking forward to another White House Conference on Small Business. Will we be sunsetting an important voice for small business at the very moment we are shaping the future direction of our efforts?

Wherever the debate on the effectiveness of specific SBA programs takes us, we cannot afford to allow the debate to take place without addressing the question of future participation of small business in national policy decisions.

Government Reliance on the Private Sector/Non-Profit Competition

Adoption of a policy of government reliance on the private sector should be a major priority of the committee. Now, more than ever, we must adopt a firm policy on this subject. Budget savings in the order of $20-30 billion could be achieved. In recent months, OMB has instituted some changes in Circular A-76 which were designed to expedite the process of "contracting out". We fear the ultimate outcome of this effort will be to demonstrate the fragile nature of policy built on an OMB circular. We appeared before this Committee in 1984 to discuss our problem with federal nurseries. The litany is familiar to this Committee, but not to the Congress as a whole. We must secure passage of a national policy statement of reliance on the private sector.

Along the same lines, competition from the non-profit sector, aided and abetted by federal policy must be addressed in this Congress. Our industry is confronted by two specific non-profit problems. A number of our firms operate as mailorder houses selling plant material and associated goods through catalogue sales. To our knowledge there are organizations which have been established as non-profit organizations, generally holding 501(c)(3) status as tax exempt. In turn, based on their tax exempt status, they obtain the appropriate postal permits for mailing at non-profit rates. Ostensibly, these organizations are established for some educational or charitable purposes. The tax-exempt status, subsidized mailing rates, and the aura of "special purpose" which governmental recognition of non-profit status conveys, results in a substantial edge for these firms over their for-profit competitors. The obvious difficulty we have in pursuing our concerns is the problem of demonstrating that these firms are really in the business of selling goods rather than advancing some special purpose.

The second category of problems is, in part, related to the decline in charitable giving to legitimate non-profit organizations such as churches, schools, auxiliaries and the like. In recent years, the operation of a small nursery or greenhouse has become an attractive alternative for raising income from non-dues sources. While we generally have no objection to the casual sale of items to raise funds, we cannot condone the full time operation of such facilities, some of which have apparently grown into lucrative operations. Such facilities are subsidized by public funds and the privileges of non-profit status.

Many municipalities, states and soil conservation districts have established nurseries which not only provide plant material for the "parent" entity, but also sell to the public. Some of these nurseries are "free-standing" and could be considered non-profit as opposed to governmental competition. In either event, they represent unfair competition.

Environmental Issues

In 1985-86, small business will be faced with new environmental regulations which are certain to be controversial at the very least. The EPA is under a Congressionally imposed deadline to issue regulations governing the disposal of hazardous waste and the use of underground storage tanks. We fear the full impact of the 1984 law is not fully understood within the small business community. The committee should monitor these matters closely and work with agency and the small business community to develop a sound regulatory program before final promulgation.

The spectre of legislation covering groundwater contamination and the application of pesticides concerns us, and we hope any discussion on these subjects will fully address the concerns of small business.

Equal Access to Justice

We support the re-enactment of the Equal Access to Justice Act. EAJA proved to be exactly what we predicted it would be - an effective, inexpensive deterrent to frivolous government action. The changes recommended by the 98th Congress make a good law better. The EAJA should be placed on an expedited legislative track.

Other Matters

We see many other matters which will be of vital concern to small business.

We oppose immigration reform which places the onus of enforcement on the backs of business. We support passage of product liability reform. Provisions which would prevent the inclusion of retailers in law suits when they did nothing more than sell a product in a responsible way, is of particular importance.

Finally, we believe it almost goes without saying that reduction of the federal deficit is a top priority. At this time, we see the adoption of an across the board freeze on all government programs as a fair solution.

Issues & A United Small Business Community

In the last year we have participated in the deliberations of the SBLC Issues Conference, the Small Business National Issues Conference, and the Chamber's Small Business Council, and we work closely with both SBU and NFIB. We wholeheartedly endorse the agenda which have emerged from these efforts, and we note the remarkable similarity among them all. Small business is united more than ever. While the economy on the whole is doing well, we cannot help but sense a certain uneasiness among the small business owners in this country that there has been some erosion of their status within our economy. We look forward to the 1985-86 White House Conference on Small Business. We continually need to define our course, marshall our resources and fight for those programs which allow us to lead the nation and the world in job creation, innovation and competition.

We look forward to working with this committee to shape national policy aggressively in ways to encourage the growth of small business.

Thank you.

NAMC NATIONAL ASSOCIATION OF MINORITY CONTRACTORS
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STATEMENT BY

NATIONAL ASSOCIATION OF MINORITY CONTRACTORS

PRESENTED TO

UNITED STATES SENATE
COMMITTEE ON SMALL BUSINESS

FEBRUARY 6, 1985

JAMES H. CHANDLER, JR	DEWEY THOMAS, JR
PRESIDENT	EXECUTIVE DIRECTOR

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, ON BEHALF OF OUR NATIONAL MEMBERSHIP AND CONSTITUENTS, I WOULD LIKE TO THANK YOU FOR THE OPPORTUNITY TO TESTIFY BEFORE YOU TODAY ON THE ISSUE THAT WILL FACE THIS COMMUNITY, AND THE 99TH CONGRESS, RELATED DIRECTLY TO THE IMPACT ON SMALL AND MINORITY BUSINESS.

THE NATIONAL ASSOCIATION OF MINORITY CONTRACTORS (NAMC) IS A FULL SERVICE, NON-PROFIT MINORITY BUSINESS TRADE ASSOCIATION, ESTABLISHED IN 1969 TO ADDRESS THE NEEDS AND CONCERNS OF MINORITY CONSTRUCTION CONTRACTORS NATIONWIDE. CURRENTLY, NAMC'S MEMBERSHIP, COMPRISED OF BLACKS, HISPANICS, WOMEN, AND ASIANS, COVERS 37 STATES, THE DISTRICT OF COLUMBIA, AND THE VIRGIN ISLANDS. NAMC IS HEADQUARTERED IN THE NATION'S CAPITOL, AND INCLUDES GENERAL CONTRACTORS, SUBCONTRACTORS, CONSTRUCTION MANAGERS, MANUFACTURERS, CONSTRUCTION SUPPLIERS, LOCAL MINORITY CONTRACTOR ASSOCIATIONS, FUNDED TECHNICAL ASSISTANCE ORGANIZATIONS, AND OTHER ASSOCIATED ORGANIZATIONS.

RATHER THAN ADDRESSING THE ABOVE-MENTIONED ISSUE GENERALLY, WE FEEL THAT OUR TESTIMONY WOULD BEST SERVE THE INFORMATIONAL NEEDS OF THE COMMITTEE IF IT IS TAILORED TO REFLECT THE CONCERN OF OUR MEMBERSHIP AND CONSTITUENCY.

MINORITY BUSINESS IN TODAY'S ECONOMY

THE HISTORY OF RACIAL/ETHNIC MINORITIES IN THE UNITED STATES IS GENERALLY ONE OF INEQUITY AND MARGINAL ACCESS TO PATHS OF UPWARD MOBILITY. IN ALMOST EVERY CATEGORY OF STATUS, ADVANTAGE OR ECONOMIC

WELL-BEING, THEY ARE GREATLY UNDER REPRESENTED. THIS CAN BE SEEN CLEARLY WHEN ONE EXAMINES THE LIMITED DEGREE TO WHICH MINORITIES PARTICIPATE IN MAINSTREAM ECONOMIC ACTIVITY.

THE RISING TRENDS IN THE RATES OF INFLATION, UNEMPLOYMENT, AND INTEREST RATES IN THE NOT SO DISTANT PAST ARE WELL KNOWN. WHILE THE EFFECTS OF THESE TRENDS IMPACTED UPON THE GENERAL BUSINESS COMMUNITY, THEY HAVE EXACERBATED THE ALREADY DISMAL BUSINESS CLIMATE OF MINORITY ENTREPRENEURS.

UNDERCAPITALIZED FIRMS ARE HURT MOST DURING PERIODS OF RECESSION AS A RESULT OF THE INCREASED INACCESSIBILITY TO FINANCING AND CREDIT. MOREOVER, HIGHER SUPPLY COSTS, INTEREST RATES AND WAGES THAT ARE CHARACTERISTIC OF INFLATIONARY PERIODS FURTHER WEAKEN MINORITY BUSINESSES' COMPETITIVE POSITION.

WHILE ECONOMIC REVITALIZATION PROGRAMS ALREADY IN PLACE MAY BENEFIT BOTH MAJORITY AND MINORITY-OWNED BUSINESSES, THEIR GREATEST VALUE IN THE SHORT RUN WILL BE TO MAJORITY FIRMS. CURRENT PROGRAMS ARE PRIMARILY AIMED AT LARGER CAPITAL-INTENSIVE CORPORATIONS, WITH AN EMPHASIS ON CAPITAL ACCUMULATION. MINORITY BUSINESSES, ON THE OTHER HAND, ARE SMALL, I.E., 99 PERCENT HAVE ASSETS OF UNDER $1 MILLION, AND ARE, FOR THE MOST PART, LABOR-INTENSIVE.

IN COMPANIES OF THIS TYPE, THE ADVANTAGES OF SUCH PROGRAMS AS ACCELERATED DEPRECIATION AND RESEARCH AND DEVELOPMENT TAX CREDITS ARE ALMOST NON-EXISTENT. SIMILARLY, REDUCTIONS IN INCOME TAXES AND ESTATE AND GIFT TAXES ARE OF LITTLE VALUE, SINCE MOST MINORITY BUSINESS

OWNERS ARE IN THE LOWER TAX BRACKETS ALREADY.

IN ORDER TO CONTINUE TO PROMOTE A SUSTAINABLE ECONOMIC RECOVERY, MINORITY BUSINESSES MUST BE ALLOWED TO PARTICIPATE IN THE REVITALIZATION PROCESS. MINORITY OWNED BUSINESSES HAVE THE POTENTIAL TO HELP SOLVE SOME OF SOCIETY'S MOST INTRACTABLE PROBLEMS INCLUDING MINORITY UNEMPLOYMENT AND THE DECAYING OF AMERICA.

NAMC'S CONCERNS, RELATING DIRECTLY TO THE DEVELOPMENT OF EMERGING SMALL AND MINORITY FIRMS

WE REQUEST THAT THE SENATE COMMITTEE ON SMALL BUSINESS ADDRESS THE FOLLOWING ISSUES IN THE 99TH CONGRESS:

1) **SUPPORT THE CONTINUATION OF THE U.S. SMALL BUSINESS ADMINISTRATION**
2) **TAX REFORMS TO INCLUDE INCENTIVES FOR SMALL AND MINORITY BUSINESS TO CREATE JOBS WITHOUT THE LOSS OF TAX REVENUE TO THE FEDERAL GOVERNMENT**
3) **SIMPLIFICATION OF FEDERAL GOVERNMENT PROCUREMENT PROCESS**
4) **INCREASE PROCUREMENT OPPORTUNITIES FOR SMALL AND MINORITY BUSINESS**
5) **INFRASTRUCTURE LEGISLATION THAT WILL INCLUDE MINORITY AND SMALL BUSINESS FULL PARTICIPATION**
6) **BETTER GOVERNMENT UTILIZATION OF P.L. 95-507 & P.L. 97-424**
7) **CAPITAL FORMATION FOR SMALL AND MINORITY BUSINESS RE: BANKS, INTEREST RATES AND CORPORATION FOR SMALL BUSINESS INVESTMENT (COSBI)**

THE IMPACT ON CONTRACTOR OPPORTUNITY

TODAY, ONE OF THE MOST PRESSING PROBLEMS FACING STATES AND CITIES IS THE NEED TO REBUILD AND REPAIR A HUGE PART OF THEIR PUBLIC

CAPITAL - THE INFRASTRUCTURE PROBLEM. IT HAS BECOME WELL KNOWN THAT WE HAVE SERIOUS DEFICIENCIES IN OUR HIGHWAYS, BRIDGES, RAIL SYSTEMS, URBAN TRASIT SYSTEMS, PORTS, INLAND WATERWAYS, DAMS, URBAN WATER SYSTEMS, AND WASTE TREATMENT SYSTEMS. THE REHABILITATION, CONSTRUCTION, AND MAINTENANCE OF INFRASTRUCTURE IS CRUCIAL NOT JUST TO THE NATION'S MUNICIPALITIES BUT TO THE COUNTRY AS A WHOLE. AMERICAN BUSINESS AND FARMING DEPEND ON THE SMOOTH FUNCTIONING OF PUBLIC WORKS. IF PRODUCERS CAN'T GET THEIR PRODUCTS TO MARKET ON TIME,PRICES INCREASE AND COMPETITIVENESS DECLINES. IF BASIC SERVICES SUCH AS WATER SUPPLY OR SEWAGE ARE LIMITED, THEN FIRMS ARE HAMPERED IN THEIR ABILITY TO EXPAND AND PROVIDE MORE JOBS AND INCOME.

YET, THERE HAS BEEN A STEADY DECLINE IN PUBLIC WORKS SPENDING. THE RATE OF CAPITAL INVESTMENT AS A PERCENT OF GNP HAS DROPPED FROM 3.3 PERCENT OR MORE IN THE 1960s TO 2.1 PERCENT IN 1982 (SEE TABLE 1). THIS DECLINE HAS HAD A DEVASTING IMPACT ON CONTRACTOR OPPORTUNITY IN THE DEPRESSED CONSTRUCTION INDUSTRY. AS A RESULT, UNEMPLOYMENT IN THE CONSTRUCTION INDUSTRY HAS BEEN RUNNING OVER 20 PERCENT - DOUBLE THE NATIONAL RATE. FURTHERMORE, MINORITY CONTRACTORS, WHO HAVE ALWAYS BEEN THE ONES WHO PHYSICALLY BUILD THE ROADS, BRIDGES, AND BUILDINGS, HAVE FOUND IT INCREASINGLY DIFFICULT TO PARTICIPATE IN THE GOVERNMENT PROCUREMENT PROCESS, INCLUDING THE SHELTERED MARKET.

THE ENACTED SURFACE TRANSPORTATION ASSISTANCE ACT ADDRESSES BOTH THE UNEMPLOYMENT PROBLEM AND THE INFRASTRUCTURE PROBLEM AS IT RELATES TO REBUILDING OUR NATION'S HIGHWAYS, BRIDGES, AND MASS TRANSIT SYSTEMS. OF PARTICULAR INTEREST TO MINORITY CONTRACTORS IS SECTION

TABLE 1

GOVERNMENT EXPENDITURES FOR CAPITAL INVESTMENT

(in constant 1981 dollars)

Year	Federal Direct	Federal Grants-in-Aid	State and Local	Total	As a Percent of GNP
1961	$6.4	$8.5	$33.8	$48.7	3.3
1963	7.8	9.5	38.4	55.7	3.4
1965	9.3	13.0	42.7	65.0	3.6
1967	8.5	12.5	53.1	74.1	3.7
1969	6.3	13.5	55.3	75.0	3.5
1971	7.0	14.2	51.7	72.9	3.3
1973	8.5	14.5	49.7	72.9	3.0
1975	7.9	14.1	51.2	73.2	3.0
1977	8.7	22.9	30.9	62.5	2.3
1979	9.7	23.6	34.0	67.3	2.3
1981	9.9	22.2	33.5	65.6	2.2
1982 estimated	9.0	20.5	29.7	59.2	2.1
1983 estimated	7.6	17.3			

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1) Deflated with the "gross private domestic fixed investment deflator." For 1982 and 1983, estimates assume 6 percent annual growth in the fixed investment deflator.

Source: U.S. Office of Management and Budget, Budget of the U.S. Government, Special Analysis; U.S. Department of Commerce, The National Income and Product Accounts of the U.S., 1929-76 Statistical Tables, and the Survey of Current Business, (July 1982); and staff calculations. Adapted from the testimony of Arnold Carter, Assistant Director, Department of Economic Research, American Federation of Labor and Council of Industrial Organization, before the Subcommittee on Economic Development, Committee on Public Works and Transportation, U.S. House of Representatives, May 3, 1983.

105(f) WHICH PROVIDES THAT NOT LESS THAN 10 PERCENT OF THE FUNDS AUTHORIZED BE EXPENDED WITH SMALL BUSINESS CONCERNS OWNED AND CONTROLLED BY SOCIALLY AND ECONOMICALLY DISADVANTAGED INDIVIDUALS. EVEN THOUGH THE AMENDMENT WAS INTENDED TO ENSURE THAT MINORITIES PARTICIPATE AS FULLY AS POSSIBLE IN THE ECONOMIC BENEFITS RESULTING FROM THE ACT, IT IS ANTICIPATED THAT A VARIETY OF PROBLEMS WILL OCCUR THAT WILL DILUTE ITS OVERALL IMPACT. PERHAPS THE GREATEST PROBLEM THAT MINORITY OWNED BUSINESSES WILL FACE IS THEIR INABILITY IN OBTAINING WORKING CAPITAL. MINORITY ENTREPRENEURS RARELY HAVE ENOUGH PERSONAL WEALTH TO FINANCE THEIR OWN BUSINESSES. MAJORITY OWNED FINANCIAL INSTITUTIONS ARE GENERALLY RELUCTANT TO TAKE "RISKS" ASSOCIATED WITH INVESTMENTS IN MINORITY BUSINESSES. ON THE OTHER HAND, MINORITY FINANCIAL INSTITUTIONS, WHO HAVE A FAR BETTER RECORD THAN NON-MINORITY INSTITUTIONS IN LENDING TO MINORITY BUSINESSES, SOMETIMES LACK SUFFICIENT ASSETS TO SERVE AS A MAJOR SOURCE OF CAPITAL. MOREOVER,THEY ARE MORE CONSUMER ORIENTED, WITH LITTLE EXPERIENCE IN DEALING WITH THE CURRENT AND FUTURE FINANCIAL NEEDS OF MINORITY CONTRACTORS.

NOTWITHSTANDING THE ABOVE, WE RECOGNIZE THAT MINORITY FINANCIAL INSTITUTIONS ARE A MAJOR SOURCE OF FINANCING FOR SMALL BUSINESSES. WE ARE, THEREFORE, QUITE CONCERNED THAT TOTAL DEREGULATION OF THE BANKING INDUSTRY COULD LEAD TO THE OBLITERATION OF LOCAL COMMUNITY BASED BANKS BY MERGER AND ACQUISITION.

ADDITIONALLY, THE HISTORICALLY HIGHER INTEREST RATES THAT MINORITY CONTRACTORS PAY FOR CAPITAL WILL FURTHER CONSTRAIN THEIR PARTICIPA-

TION IN THE PROGRAM. BECAUSE MANY SMALL BUSINESSES TEND TO BE UNDERCAPITALIZED OR FACE SUBSTANTIAL CAPITAL NEEDS TO FINANCE GROWTH, REAL HIGH INEREST RATES CAN CAUSE SEVERE CASH FLOW PROBLEMS FOR THESE FIRMS. SO, UNDERSTANDING THE ORIGIN OF HIGH INTEREST RATES IS CRITICAL TO OUR REVIEW TODAY.

INTEREST RATES

WHILE THERE MAY BE SOME LINK CURRENTLY AND PERHAPS IN THE FUTURE TO HIGH DEFICITS AND HIGH INTEREST RATES, HISTORICALLY THE CLOSER CONNECTION HAS BEEN BETWEEN INTEREST RATES AND INFLATION. WHEN THE INFLATION RATE IS HIGH, INTEREST RATES ARE PUSHED UP DIRECTLY BY THE NEED FOR BANKERS TO ADD AN INFLATION PREMIUM TO PROTECT THE REAL VALUE OF THE FUNDS THEY LEND. IN ADDITION, THE ECONOMIC INSTABILITY SUGGESTED BY THE PRESENCE OF HIGH RATES OF INFLATION LEADS TO A LARGER RISK PREMIUM IN THE COST OF CAPITAL AS WELL. AS A RESULT, MINORITY CONTRACTORS ARE COMPLETELY FORCED OUT OF THE CAPITAL MARKET.

AS A DIRECT RESULT OF THE STERN ECONOMIC MEASURES THE PRESIDENT, THE CONGRESS, AND THE FEDERAL RESERVE BOARD UNDERTOOK IN 1981, THE INFLATION RATE HAS DROPPED FROM 11.7 PERCENT IN 1981 TO APPROXIMATELY 3.2 PERCENT IN 1983. AS A RESULT, THERE HAS BEEN A SIGNIFICANT DROP IN SHORT-TERM REAL INTEREST RATES OVER WHAT THEY WERE BEFORE THESE MEASURES WERE TAKEN. FROM A HIGH OF 21.5 PERCENT FOUR YEARS AGO, THE PRIME RATE WAS CUT IN HALF AND HAS REMAINED STEADY AT 11.0 PERCENT DURING THE PAST YEAR.

WHAT REMAINS PUZZLING IS WHY INTEREST RATES HAVE NOT DROPPED

FURTHER. AGAIN, REASONABLE INTEREST RATES SHOULD BE THE TOTAL OF THREE FACTORS: (1) A FAIR RATE RETURN ON CAPITAL, SAY THREE OR FOUR PERCENT; (2) AN INFLATION PREMIUM, SAY 3.5 PERCENT; AND (3) AN ECONOMIC RISK PREMIUM. GIVEN THAT THE RATE OF INFLATION HAS BEEN STEADY AND MOST ECONOMIST BELIEVE IT WILL REMAIN STEADY FOR THE NEXT YEAR, THE DIFFERENCE THEN BETWEEN MORE DESIRABLE INTEREST RATES IN THE 8 OR 9 PERCENT RANGE AND WHAT WE HAVE NOW, AND MOST IMPORTANTLY FOR THIS HEARING, WHAT WE WILL HAVE IN THE FUTURE, IS EITHER LENDING INSTITUTIONS SEEKING HIGHER THAN NORMAL RATES OF RETURN ON THEIR CAPITAL OR THESE INSTITUTIONS EXACTING A LARGER THAN EXPECTED ECONOMIC RISK PREMIUM OR BOTH.

LEAVING ASIDE THE MATTER OF THE POSSIBILITY OF PROFIT MAXIMIZATION, LET ME FOCUS ON THE QUESTION OF THE CONCERNS OF FINANCIAL MARKETS ABOUT THE ECONOMY.

HIGH DEFICITS

HISTORICALLY, THE LACK OF CONFIDENCE FINANCIAL MARKETS MIGHT HAVE HAD ABOUT OUR ECONOMIC FUTURE HAVE FOCUSED MORE ON INFLATION AND THE RATE OF GROWTH IN THE MONEY SUPPLY THAN THEY HAVE ABOUT DEFICITS. THERE WAS A GENERAL COMPLAINT FOUR YEARS AGO THAT MONETARY POLICY SHIFTED TOO OFTEN, THAT MONEY WAS TOO TIGHT, AND THAT VERY HIGH INTEREST RATES WERE THE RESULT.

TODAY, MANY THINGS HAVE CHANGED. INFLATION IS DOWN, GONE ARE THE ERRATIC CHANGES IN THE MONEY SUPPLY, UNEMPLOYMENT HAS BEEN DECLINING, BUT WHAT HAS NOT CHANGED IS UNCERTAINTY IN FINANCIAL MARKETS ABOUT THE ECONOMY. TODAY, DEFICITS HAVE REPLACED INFLATION AND MONEY SUPPLY AS THE PRINCIPAL SOURCE OF UNCERTAINTY. WHILE THAT UNCERTAINTY HAS NOT BEEN TRANSLATED INTO HIGHER INTEREST RATES YET, IF TALK ABOUT DEFICITS OUTPACES ACTION IT COULD DO SO IN THE FUTURE. MEANWHILE, THE UNCERTAINTY IS ONE OF THE REASONS WHY RATES HAVE NOT FALLEN TO LOWER LEVELS PREVIOUSLY.

DEFICITS WILL BECOME A PROBLEM FOR SMALL BUSINESS IF THE GROWTH IN FEDERAL CLAIMS ON CAPITAL MARKETS TO FINANCE THE DEFICIT OUTPACES THE GROWTH IN THOSE MARKETS SPARKED BY ECONOMIC RECOVERY. ONE OF THE REASONS WE BELIEVE DEFICITS HAVE NOT BEEN A PROBLEM THUS FAR IS THE TAX CUTS AND TAX REFORMS HAVE MADE SAVINGS AND INVESTMENT MORE ATTRACTIVE TO MORE AMERICANS AND THAT HAS LED TO GREATER INVESTMENTS. EVEN AS UNCLE SAM DIPS DEEPER INTO THE POOL OF CAPITAL TO SATISFY THE DEFICIT, EARLIER REFORMS ARE DEEPENING THE POOL.

WE BELIEVE THE REAL CONCERN OF SMALL BUSINESS IS WHAT IS DONE ABOUT THE DEFICITS. IF THE FEDERAL GOVERNMENT INCREASES TAXES TOO SHARPLY TO BRING THE BUDGET INTO BALANCE, IT WILL REDUCE SAVINGS RATES AND INVESTMENT CAPITAL AVAILABILITY TO SUCH AN EXTENT THAT THE POOL OF CAPITAL THAT ALL OF US UTILIZE WILL SHRINK AND THE NEGATIVE IMPACT ON THE POOL CAUSED BY DEFICITS WILL INCREASE DRAMATICALLY. IN OTHER WORDS, IF WE RAISED TAXES BY $200 BILLION A YEAR TO CLOSE THE BUDGET GAP, NAMC IS CONCERNED THAT THIS WOULD DRY UP INVESTMENT TO SUCH AN EXTENT THAT SMALL BUSINESSES WOULD BE CROWDED OUT OF FINANCIAL MARKETS. THE EFFECT OF THIS COULD BE DEVASTATING, GIVEN THE SPECIAL ROLE IN JOB CREATION THAT SMALL BUSINESSES PLAY IN THE AMERICAN ECONOMY.

CONGRESS AND THE PRESIDENT NEED TO EXERCISE EXTREME CAUTION IN BOTH RELYING TOO MUCH ON EITHER TAXES OR EXPENDITURE CUTS IN BRINGING THE BUDGET INTO LINE. EXCESSIVE SOCIAL CUTS WOULD HURT MANY OF THE PERSONS THAT THE MINORITY SMALL BUSINESS COMMUNITY SEEKS TO HELP. A BALANCED APPROACH MUST BE FOUND.

CONCLUSION

NAMC STRESSES THE IMPORTANCE OF PURSUING ECONOMIC POLICIES WHICH REDUCE THE COST OF CAPITAL INVESTMENT TO STATE AND LOCAL GOVERNMENTS SO THAT THEY CAN MEET THE INFRASTRUCTURE NEEDS OF AMERICA. AN EXPANDING STATE AND LOCAL CONSTRUCTION MARKET WILL GIVE SMALL AND MINORITY FIRMS A CHANCE TO COMPETE AGAINST LARGER, MORE ESTABLISHED FIRMS FOR A LARGER SLICE OF AN INCREASING PIE. THIS IS ESPECIALLY IMPORTANT FOR 8(a) FIRMS WHICH HAVE BEEN TACITLY ENCOURAGED TO DEPEND UPON FEDERAL LARGESSE BUT ARE NOW FACED WITH LEGISLATION THAT LIMITS THEIR TENURE IN THE SHELTERED MARKET PROGRAM.

THE MAINTENANCE OR REDUCTION OF THE CURRENT RATES OF INTEREST WILL DEPEND ON CONTINUING CONTROL OF INFLATION AND THE MONEY SUPPLY AND THE COMBINED COMMITMENT BY THE PRESIDENT AND THE CONGRESS TO INCREASE FINANCIAL COMMUNITY CONFIDENCE IN THE FUTURE OF THE ECONOMY BY UNDERTAKING BUDGET BALANCING INITIATIVES THAT DO NOT DRY UP CURRENT SOURCES OF INVESTMENT NOR CUT TOO HEAVILY INTO EXISTING GOVERNMENT PROGRAMS.

LAMA
Latin American Manufacturers Association

TESTIMONY

before the

United States Senate
99th Congress
Committee on Small Business
Senator Lowell Weicker, Jr., Chairman
Senator Dale Bumpers, Ranking Minority Member

Concerning the Administration's proposal to abolish SBA,
the historic pattern of underrepresentation of
Hispanics in the 8a program, and related matters.

Presented by

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Mr. Chairman,

My name is Stephen Denlinger and I am President of LAMA - the Latin American Manufacturers Association. I join our Chairman, Mr. Art Lopez, the members of our Board of Directors, and our membership nationwide in thanking you for this opportunity to appear before your Committee today.

LAMA, as you will recall, is a national association of Hispanic firms in manufacturing, electronics, information sciences, technical consulting, telecommunications, and other technical pursuits. Sales of our firms range from $250,000 to $50 million per year. Most firms are in the defense business doing work as subcontractors to prime contractors on major weapons systems or, on a more limited basis, they are prime contractors to the government (the latter, primarily through the vehicle of the SBA 8(a) program).

Mr. Chairman, my testimony today will focus on three issues - the proposal to abolish the SBA - the historic pattern of underrepresentation of Hispanics in the 8(a) program - and graduation provisions of the 8(a) program.

SMALL BUSINESS ADMINISTRATION

I am here today, Mr. Chairman, to tell you that our constituency is in shock over the seriousness and determination of the Administration to abolish the SBA. The Hispanic business community is one of the prime user constituencies of SBA's programs. The Administration's proposal to abolish the SBA stands in stark contrast to the often repeated, glowing statements by the President and various Cabinet members as to the significance of of the small business sector in the economic recovery.

We actively supported the President's tax and budget proposals in 1981 wherein SBA took a 27% cut. We do not support this small business proposal nor the allocation of the budget cuts in general, particularly in view of the abstention of DOD from the budget process. The proposal is not fair. While all of the credit programs of the SBA would be abolished under the Administration's proposal, the farm support programs would be reduced by approximately 25% and Defense would remain untouched.

We do not support this small business proposal nor the allocation of the budget cuts in general, particularly in view of the abstention of DOD from the budget process.

The main points I would like to stress are as follows:

1. The President's proposal would abolish the key advocacy agency supporting small business - the small business community needs and independent, self-standing agency to protect its interests;

2. With SBA gone, the Small Business Committees would loose their legislative jurisdiction, further eroding the institutional fabric of the small business sector;

3. The small business issues of the day will fall through the cracks when legislative jurisdiction reverts to the Commerce, and Ways and Means Committees of the Congress;

4. The Administration§s proposal to abolish SBA makes a mockery of the 1986 White House Conference on Small Business - the implementation of a White House Small Business Conference by the White House that abolished the SBA would be seriously lacking in credibility;

5. There would no longer be a lender of last resort - discrimination in the private markets against minority companies will again shut out a significant percentage of our constituency, and the concept of credit programs for business development will have vanished;

6. Stockman's claim that SBA only helps 1/10% of 1% of the small business community is false particularly when viewed over a period of years - over the past decade, for instance, SBA's credit programs have helped approximately 10% of small businesses having employees or about 10% of those small businesses which actually seek financial assistance in the financial markets;

7. Numerous groups, including the NFIB, have shown rather convincingly that the savings postulated by Stockman by abolishing SBA are way off the mark;

8. The transferance of the procurement, management assistance, and minority business development programs to the Department of Commerce will subject them to years of turmoil as Commerce absorbs these programs, develops a delivery system, and learns how to operate these programs;

9. The Department of Commerce has no recognizable history of effective advocacy for the small business sector. Given the proposed reorganization of Commerce into an agency whose primary function is to promote international trade, the transference of the small business programs to Commerce is illogical and ill-advised.

The President is exhorting the Congress, business leaders and the country on the critical need for these drastic reductions. Yet let us not forget that it has been the President's program of expanded defense spending, reduced taxes, and the expectation that economic recovery would close the revenue gap that has gotten the country into this defecit predicament. We are willing to share in the defecit reduction effort provided there is a sense of fair play involved. Yes, SBA can be trimmed. Yes, some SBA programs can be eliminated. No, the agency should not be abolished. No, the programs should not be transferred to Commerce.

HISPANIC UNDERREPRESENTATION IN 8(a) PROGRAM

Historically, Hispanics have been underrepresented in the 8(a) program. For the past decade, Hispanics have represented approximately 20% of the portfolio (Blacks - approximately 65%). Some regions are worse than others. In California (Region IX), for instance, wherein Hispanics constitute around 64% of the minority population, Hispanics represent only around 31% of the 8(a) portfolio.

For the past decade, Hispanics have received approximately 15% of the dollar value of all 8(a) contracts (Blacks - approximately 70%). The disparity is much worse in specific agencies/administrations, such as HUD, HHS, NASA, FAA, etc.

The 8(a) program now awards over $1 billion annually in contracts to its portfolio members. The shortfall to Hispanics from underrepresentation in the 8(a) program is in the hundreds of millions of dollars.

Pursuant to management initiatives by the current SBA administrator, Mr. James Sanders, we are beginning to see an improvement in the ratio of Hispanic participation in the 8(a) program. For FY 84, for instance, the dollar value of awards to Hispanic 8(a) firms moved up to 27%. We are concerned that these gains be consolidated and improved.

RECOMMENDATION - We recommend that the SBA be legislatively mandated: to conduct the 8(a) program in a manner which is more fully representative of Hispanics, Asians, and other minorities which have not shared fully in the 8(a) program; and to institute strong management initiatives to that end, including numerical goals and timetables.

TERMS IN THE 8(a) PROGRAM

Public Law 96-481 required SBA to establish a fixed term for every participant in the 8(a) program. SBA settled on a maximum of 7 years in a two-stage process. Most firms do not receive the 7 year maximum, and the average is probably 4 to 5 years.

As we have testified before the House Committee on Small Business, this is an insufficient amount of time for companies to achieve viability, particularly in the more technical areas such as manufacturing, telecommunications, information sciences, etc. We will be pleased to provide you with LAMA's extensive testimony on this matter as presented to the House Committee on Small Business.

RECOMMENDATION - We recommend that P.L. 96-481 be amended to provide for a maximum 8(a) term of 10 years, particularly for more technical companies such as manufacturing, telecommuncations, information sciences, etc.

Mr. Chairman, this concludes my remarks for purposes of this hearing. Thank you for your strong posture of support for small business.

LAMA

Latin American Manufacturers Association
Winter, 1984

DOD AWARD

Minority Prime Contractor of the Year

CASDE Corporation

Deputy Secretary Taft Presents the Award

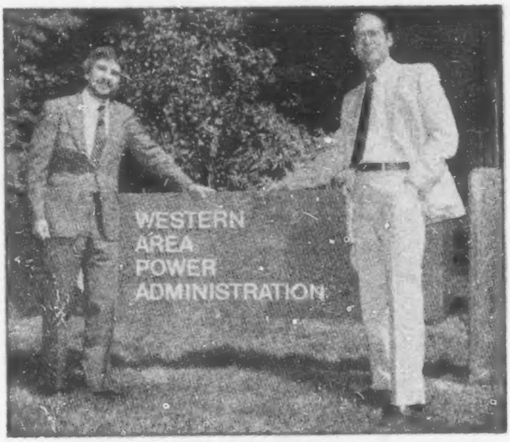
Deputy Secretary of Defense, William H. Taft, presents the Minority Prime Contractor of the Year award to LAMA member, Dr. Robert Saucedo, President, CASDE Corporation, a naval engineering firm located in Torrance, CA.

The CASDE Corporation, a Hispanic naval engineering firm located in Torrance, California, was recently selected by DOD for the Minority Prime Contractor of the Year award. Deputy Secretary of Defense, William H. Taft, presented the award to CASDE's, President, Dr. Robert Saucedo, at a ceremony at the Pentagon. In presenting the award, Secretary Taft said, "In honoring this firm today, we are paying public recognition to all the minority businesses that have played such an important role in restoring America's defenses." In his remarks, Secretary Taft went on to single out CASDE as one of the best minority firms in the country and lauded CASDE's "commitment and spirit in fulfulling contract requirements for the Department of Defense."

CASDE is providing services to the Navy in the areas of survivability, structural design, computer engineering, and human factors. The firm's owner and founder, Dr. Robert Saucedo, stated that he was deeply honored by the award and that he was extremely appreciative of DOD's providing his firm the opportunity to demonstrate CASDE's technical excellence. Dr. Saucedo indicated that this represented an "outstanding example of the positive benefits associated with SBA and DOD cooperating in promoting the involvement of qualified minority firms in technical DOD work." CASDE is presently performing on a $10 million, multi-year naval engineering services requirement for the Navy. "Without SBA's participation and support," stated Dr. Saucedo, "this would not have been possible."

Dr. Robert Saucedo, President, CASDE Corporation, is congratulated for his Minority Prime Contractor of the Year award by Irenemarie Castillo, Deputy Administrator of SBA, Robert Saldivar, Deputy Associate Administrator, SBA (now OSDBU Director at the Navy), and Art Lopez, Chairman of LAMA.

"I would like to express my appreciation to LAMA," indicated Dr. Saucedo to Art Lopez, LAMA's Chairman, "for assistance in helping me understand the intricacies of these programs. LAMA has been an outstanding partner to CASDE and has been especially helpful in facilitating decisions and the flow of documents at the SBA in relation to the large Navy requirement which CASDE is now performing."



Mr. Celestino Archuleta (left), President of National Systems and Research, and Mr. Carlos Suarez, Regional Administrator for SBA in Denver, at a recent photo ceremony in recognition of NSR's outstanding service to WAPA—the Western Area Power Administration.

NATIONAL SYSTEMS & RESEARCH

Successful WAPA Contractor

SBA-RA Carlos Suarez Plays Key Role

National Systems and Research Co. (NSR), a Hispanic information sciences firm based in Colorado Springs, Colorado, was recently recognized for "outstanding performance" by officials of the Department of Energy's Western Area Power Administration (WAPA). At the photo ceremony, Mr. Sal Cianella, WAPA's Assistant Administrator for Management Services, informed Mr. Carlos Suarez, SBA Regional Administrator from Denver, that "our relationship with NSR has been extremely good, and NSR is a credit to our outstanding small and minority business program. You can be proud of the manner in which the company has performed for us."

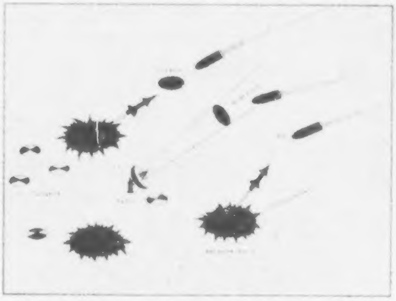
NSR Commended—Officials present for WAPA's commendation to NSR include (left to right): Mr. Carlos Suarez, SBA Regional Administrator; Mr. Stephen Denlinger, President of LAMA; Mr. Joe Strong, Director, ADP Division; Mr. Sal Cianella, Assistant Administrator for Management Services; Mr. Celestino Archuleta, President, NSR; and Mr. David Waltzman, Director, Procurement Division.

Mr. Suarez indicated that he was gratified by the relationship between NSR and WAPA. "Officials in SBA's district office originally requested the entire $20 million project for NSR," stated Mr. Suarez, "and WAPA resisted strongly because they had no experience with NSR. When it got up to my level," he continued, "I suggested that WAPA offer 25% of the requirement to NSR." The approach worked, and NSR was awarded around $5 million over a five-year period. "WAPA has been so pleased with NSR," continued Mr. Saurez, "that they have increased the level of effort with NSR to about $15 million over five years, at three different geographic locations involving almost 80 NSR employees."

NSR's President, Mr. Celestino Archuleta, indicated that he was "proud to be part of the vanguard of the Hispanic firms penetrating the high technology market in the Federal government." The breadth of the services provided by NSR to WAPA encompasses the complete spectrum of ADP systems development and support, from defining requirements through design, implementation, operation, and maintenance at the WAPA offices in Sacramento, California, and Fort Collins, Colorado. NSR is also responsible for security and configuration management of all WAPA ADP systems at the headquarters in Golden, Colorado.

WAPA is responsible for the Federal electric power marketing and transmission functions in 15 central and western states. It sells electric power to over 500 customers consisting of cooperative municipalities, public utility districts, private utilities, Federal and state agencies, and irrigation districts, which, in turn, provide services to millions of retail customers. "This work with WAPA is especially important to my company," stated Mr. Archuleta, "because it is spread out over several years and provides us with a stable foundation which will greatly facilitate the development and success of my firm. I am extremely grateful to SBA and WAPA for this important opportunity."

The representatives of WAPA, SBA, and NSR also expressed their appreciation to LAMA's President, Mr. Stephen Denlinger, for the constructive role played by LAMA in the consummation of the project. "While it was all new to me," stated Mr. Archuleta, "LAMA really knew the ropes and greatly facilitated this award for NSR." Mr. Suarez stated that "LAMA seems to have a knack for knowing how to assist Hispanic firms, such as NSR, in capturing government contracts."



Nuclear Blackout Simulation—The drawing represents a computer simulation, developed by NSR, characterizing the effects of nuclear fireballs and gamma region blackout from multiple nuclear re-entry vehicles delivered by ICBMs.

In addition to services provided for the Department of Energy (DOE), NSR has contracts with the Department of Defense and the Department of the Interior. The most significant efforts in DOD programs are in developing and integrating large information systems in the area of strategic weapon logistics for the Naval Aviation Logistics Center and the Naval Ships Parts Control Center, and in providing services for the North American Aerospace Defense Command/Aerospace Defense Command (NORAD/ADCOM) and Space Command (SPACECMD), Department of the Air Force. NSR's involvement in the defense area includes programs such as the Military Strategic-Tactical and Relay (MILSTAR) satellite system, the Survival Communications Integration System (SCIS), the Communication Systems Segment Replacement (CSSR), and the Rapid Emergency Reconstitution (Rapier) program. NSR is providing Command, Control, and Communication (C^3) expertise to Federal agencies in the areas of systems engineering and analysis, systems integration, logistics, training, test planning, operations, radioactive environments, requirements definition, and acquisition management.

Trade Association of the Year

LAMA was recently selected the Minority Trade Association of the Year for 1984 by MBDA. In presenting the award to LAMA, Mr. James Richardson-Gonzalez, MBDA Director, commended LAMA for its "outstanding support of Hispanic manufacturing and technical firms."

In his remarks, Mr. Richardson highlighted one of LAMA's notable successes, a $96 million, high-tech contract to Computer Technology Associates, for the computer integration of missiles to the F-18 Fighter. In accepting the MBDA award, LAMA's Chairman, Mr. Art Lopez, expressed appreciation for the "true partnership which has developed between LAMA and MBDA over the past year."

MBDA Director, Mr. James Richardson-Gonzalez, presents the Minority Trade Association of the Year award to LAMA's chairman, Mr. Art Lopez, accompanied by Mr. Lou Arranaga, Secretary, and Mr. Stephen Denlinger, President of LAMA.

Hispanic Participation Improving

SBA Administrator James Sanders

SBA Administrator James Sanders recently announced that Hispanic firms received almost 27% of all 8(a) awards in FY 84 as compared to 17.6% in FY 1983. "Hispanic firms," he explained, "received $300 million more in 8(a) contracts in FY 84 than in FY 83." (SBA statistics show that Hispanics received $390 million in 1983 and $690 million in 1984.)

"Due to the increase in total 8(a) awards this year," continued Mr. Sanders, "we were able to achieve the improvement in Hispanic participation in the program without adversely affecting other groups." The Administrator also indicated that there is a steady upward trend in the percentage of Hispanic firms in the portfolio. "Hispanic participation is now almost 25% of the 8(a) portfolio."

SBA 8(a) Regulations

LAMA recently convened a meeting of Hispanic business owners to discuss SBA's proposed new regulations governing the 8(a) program. The meeting represented a continuation of LAMA's efforts over the past six months to manifest the concerns of the Hispanic business community over several particularly negative features of these rules.

The primary concern expressed to the top level SBA officials with whom the group met was the SIC Code limitation. Basically, under this provision of the new rules, 8(a) firms would be eligible *only* for requirements for which they had approved SIC Codes in their 8(a) business plan.

Companies participating in the LAMA meeting included firms in precision metal manufacturing, telecommunications, construction, coal brokerage, process control instrumentation, naval engineering, information sciences, microprocessor based communication systems, large metal fabrications, food services, and computer engineering.

This SIC Code limitation would cause many problems to 8(a) companies. First of all, the SIC Code system is seriously outdated and many firms have entered the 8(a) program in technologies that are not listed in the Standard Industrial Classification system (such as telephone interconnect, micro-processor based access control systems, broadband CATV, fibre-optic communication systems, etc.). In addition, there is no classification for R&D work in manufacturing technologies.

Of even greater concern, there may be wide disagreement among procurement officials as to the proper SIC Code designation for particular requirements. One 8(a) company, for instance, described how the same identical work the firm had performed at three Veterans' hospitals had been given three completely different SIC Code numbers. Under SBA's new system, the firm would not have been eligible for two of the three contracts despite the fact that the work was identical.

One of the most disturbing features of the SIC Code limitation is that procurement personnel who are unsympathetic to the 8(a) program could rather easily or arbitrarily change SIC Code designations so as to preclude an 8(a) set-aside for particular requirements.

The group made several recommendations to the Deputy Administrator of SBA, Irenemarie Castillo, as follows:

1. A more flexible approach is necessary since the present SIC Code system is outdated;
2. An opportunity for existing 8(a) firms to update their business plans is essential to the fair and equitable implementation of the new regulations;
3. 8(a) firms must be given the opportunity to include in their business plans all SIC Codes that adequately reflect the range and diversity of their business;
4. No 8(a) firm should be denied a requirement which it is qualified to perform solely because of the SIC Code limitation when the 8(a) firm can demonstrate that the requirement relates *directly* to its business plan or when the firm can show that it has performed the same or substantially similar work in the past;
5. The SBA should not let the SIC Code limitation frustrate the intent of the 8(a) program, particularly when it is apparent that agency procurement personnel are attempting to defeat 8(a) set-asides by mis-categorizing requirements under erroneous SIC codes.

LAMA

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LAMA is a national trade association of Hispanic manufacturing, technical, and industrial firms. LAMA is dedicated to promoting the expansion of Hispanic enterprise, industry and technology. This newsletter is published with the assistance of the Minority Business Development Agency, Department of Commerce. LAMA is solely responsible for its contents. Christie Shelburne, Editor.

TO:

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Small Business
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TESTIMONY

BY

PATRICK OWEN BURNS, CHAIRMAN

OF

AMERICAN ASSOCIATION OF MESBICs

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 6, 1985

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Fulcrum Venture Capital Corp
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Houston, Texas

RUBEN M. SAENZ
MESBIC of San Antonio
San Antonio, Texas

JAMES S. YU
Intercontinental Capital
Funding Corp
New York, New York

Good morning. My name is Patrick Owen Burns, and I am President of Minority Equity Capital Company, Inc. (MECCO), a minority enterprise small business investment company (MESBIC) based in New York City. I am also Chairman of the American Association of Minority Enterprise Small Business Investment Companies (AAMESBICs).

It is as Chairman of AAMESBIC, that I am here today to represent a nation wide industry of over 146 specialized investment companies. Created administratively in 1969 and through legislative mandate in 1971, MESBICs are privately capitalized, privately owned for profit venture capital firms licensed and regulated an afforded matching leverage by the Small Business Administration to provide financing and offer management guidance to small business concerns owned by minority entrepreneurs. MESBICs represent an unique private/public sector partnership which utilizes the base of long term private capital and the add-on of SBA leverage dollars which work to expand the pool of long term capital available to minority owned businesses.

By the end of 1984, the 146 licensed MESBICs were operating with total private capital of $156 million and total SBA leverage of $205 million, a total capital figure of over $361 million. During 1984, MESBICs invested $89 million in 1,087 small businesses, bringing to $392 million the aggregate total of long term "patient capital" made available by the MESBIC industry to socially or economically disadvantaged entrepreneurs since 1976. This investment figure, of course, does not give any indication of the hundreds and hundreds of millions of dollars of financing for minority owned businesses which were triggered by the MESBIC investments.

The MESBIC industry's contributions to the American economy through its thousands of investments in small businesses has been significant. Its investments have served to promote businesses which have become and remain leaders in job creation, innovation, and inner-city development.

In March of 1984, the President submitted to Congress a

REPORT ENTITLED "THE STATE OF SMALL BUSINESS". THE REPORT NOTED:

> ALL OF THE 984,000 NET NEW JOBS GENERATED IN THE AMERICAN ECONOMY DURING 1981 AND 1982 CAME FROM INDEPENDENT SMALL BUSINESSES WITH FEWER THAN 20 EMPLOYEES. SMALL BUSINESSES PRODUCED A TOTAL OF 2,650,000 NEW JOBS, MORE THAN OFFSETTING THE 1,664,000 JOBS LOST BY LARGE BUSINESSES.

THE MESBIC INDUSTRY INVESTMENT IN SUCH SMALL BUSINESSES WHICH ARE OWNED BY MINORITY AND VIETNAM-ERA VETERAN ENTREPRENEURS, ACCORDING TO SBA STATISTICS, WERE RESPONSIBLE FOR CREATING OR MAINTAINING 8,470 JOBS IN 1984 ALONE. IN ADDITION, IT IS ALSO IMPORTANT TO NOTE THAT MANY OF THESE PORTFOLIO COMPANIES ARE LOCATED IN THE INNER-CITY, AND EMPLOY MINORITIES AND MINORITY YOUTH--WHOSE UNEMPLOYMENT RATES IN RECENT TIMES REACHED AS HIGH AS 20% AND 50% RESPECTIVELY.

IN LIGHT OF THE CONTRIBUTIONS THE MESBIC INDUSTRY--AND SMALL BUSINESS IN GENERAL--HAS MADE TO THE AMERICAN ECONOMY, IT IS PARTICULARLY DISTRESSING THAT THE ADMINISTRATION IS PROPOSING THE ELIMINATION OF THE SMALL BUSINESS ADMINISTRATION. THIS AGENCY HAS STOOD AS A MAJOR ADVOCATE FOR SMALL BUSINESS, ADMINISTERING

THE SBIC AND OTHER PROGRAMS DESIGNED TO FOSTER THE CONTINUED GROWTH OF THIS VITAL SECTOR OF THE ECONOMY. DEMOLISHING THE SBA WOULD ALSO KILL REVENUE-GENERATING FINANCING VEHICLES LIKE THE SBIC PROGRAM. AS VENTURE CAPITAL INVESTORS, WE SUPPORT REDUCTION OF THE FEDERAL DEFICIT. BUT FOR VERY RELATED, BOTTOM LINE REASONS, WE OPPOSE THE ELIMINATION OF THE SBA IN ITS ENTIRETY. KEEPING IN LINE WITH REDUCING THE SBA BUDGET, THE MESBIC AND SBIC INDUSTRIES ARE WORKING ON A PROPOSAL TO CREATE THE CORPORATION FOR SMALL BUSINESS INVESTMENT (COSBI)--A PRIVATELY RUN INSTITUTION THAT WOULD REPLACE SBA AS A SOURCE OF LEVERAGE FUNDS FOR OUR INVESTMENT COMPANIES. CONGRESS PERMITTING, WE COULD BE OPERATING ON A PRIVATE FOOTING IN A COUPLE OF YEARS. BUT IF THE ADMINISTRATION KILLS THE SBIC PROGRAM ALONG WITH SBA BEFORE WE CAN MAKE THE TRANSITION, VENTURE CAPITAL FOR MINORITY BUSINESSES, ALONG WITH REGULAR SBIC INVESTMENTS, WILL DRY UP.

THE CORPORATION FOR SMALL BUSINESS INVESTMENT WILL BE A PRIVATE CORPORATION, CHARTERED BY CONGRESS, WHICH WILL ACT AS A FINANCIAL INTERMEDIARY BETWEEN THE CAPITAL MARKETS AND THE MESBIC

AND SBIC INDUSTRIES. THE CORPORATION'S ENABLING STATUTE WILL GIVE IT A SPECIAL SET OF FEDERALLY-RELATED CHARACTERISTICS WHICH CONFER "AGENCY" STATUS UPON IT (SIMILAR TO FANNIE MAE AND SALLIE MAE). AS SUCH, THE CAPITAL MARKETS WILL CONSIDER THE CORPORATION TO BE IMPLICITLY SUPPORTED BY THE FEDERAL GOVERNMENT. IT WILL THEREFORE BE CONSIDERED AN EXCELLENT CREDIT RISK, AND WILL BE GIVEN FAVORABLE INTEREST RATES IN A RANGE BETWEEN U. S. TREASURIES AND CORPORATE AAAS.

THE COSBI PROPOSAL HAS ALREADY GAINED THE SUPPORT OF THE GENERAL SMALL BUSINESS COMMUNITY. DURING ITS RECENT SMALL BUSINESS ISSUES CONFERENCE, THE SMALL BUSINESS LEGISLATIVE COUNCIL, A SMALL BUSINESS UMBRELLA ORGANIZATION REPRESENTING 88 DIFFERENT SMALL BUSINESS GROUPS, INCLUDED THE COSBI PROPOSALS AS ONE OF ITS TOP FIFTEEN LEGISLATIVE PRIORITIES FOR THE COMING YEAR.

COSBI LEGISLATION WAS INTRODUCED IN BOTH THE HOUSE AND SENATE LAST YEAR AND WILL SOON BE REINTRODUCED IN THIS CONGRESS.

We believe the Corporation will provide the industry with a stronger and more stable source of funds. The Corporation will serve as a device for expanding the availability of credit to small businesses. We therefore seek the continued support of this committee for the industry through its favorable consideration of the Corporation for Small Business Investment Act.

In conclusion, I would like to thank the Committee for allowing AAMESBIC to participate in these hearings. If you have any questions regarding my testimony, I would be happy to answer them.at this time.

STATEMENT OF

STEVEN A. JUNG

BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

February 6, 1985

Chairman Weicker, members of the Committee on Small Business. Thank you for inviting me to appear at this meeting. My name is Steven Jung. I represent the Automotive Warehouse Distributors Association.

AWDA is a nationwide trade association whose members include over 600 warehouse distributors of automotive replacment parts and nearly 250 manufacturers of such parts. Most members of AWDA are small businesses. The typical warehouse distributor has annual sales below $8 million.

This morning, I would like to ask the committee to direct its attention to two legislative priorities of the members of AWDA.

Our first priority is the promotion of methanol as an alternative to, and the eventual replacement for, petroleum based motor vehicle fuels such as gasoline. The entire automotive industry is in dire need of a national energy policy that will focus on an alternative fuel to prevent the shortages and disruptions experienced in recent years.

AWDA has made every effort to alert the business community and the public to the need for an energy policy fostering development of an alternative motor vehicle fuel. Our business, like many small businesses, is hyper-sensitive to motor vehicle usage. Usage is directly affected by the availability and the price of fuel. We are therefore dependent on the public having access to a secure, stable and affordable supply of motor vehicle fuel.

While we are in a period of relative stability, the inevitable depletion of fossil fuel sources will result in political and economic instability. It is small businesses that are devastated by the economic dislocations which have occurred in the past and will occur again.

Methanol is the viable alternative to petroleum motor vehicle fuels. Methanol is a tried and proven alternative and should be the national motor vehicle fuel to take the place of oil. No new technology is required to integrate it into the nation's motor fuel stream. It is cost effective, energy efficient, and environmentally sound. Most importantly, methanol is derived from coal and natural gas, which are in plentiful supply, and from most forms of bio-mass, including forest products and agricultural or municipal wastes, which are renewable.

We urge the committee to support measures similar to the Methanol Vehicle Incentives Act of 1984, introduced by Senator Danforth in the last session of Congress, which promote methanol fuel and remove market barriers to its use, at a minimal cost to the taxpayer. We are playing Russian roulette with the national economy, and should act now during this period of stability, or face the prospect of economic disruptions and gasoline lines later.

The second priority of AWDA addresses a problem specific to members of AWDA and the automotive aftermarket, the network of businesses that supplies parts and service to automobiles after they have been sold.

The problem arises under the performance warranty provisions in Section 207 of the Clean Air Act and the regulations of the Environmental Protection Agency promulgated thereunder. Pursuant to the Act and the regulations, numerous automobile components which may indirectly affect engine emissions must be warranted by the manufacturer of the automobile for five years or 50,000 miles. Most other car parts are typically warranted for one year or 12,000 miles.

These long term warranties create a monopoly under the hood in service repair work in favor of franchised new car dealers to the exclusion of the independent automotive aftermarket serviced by AWDA members. The monopoly arises because consumers will naturally have all covered repairs for five years handled by the franchised dealer of the car manufacturer from whom he purchased the car.

These warranties also take other repair work away from the independent aftermarket, as owners return their new cars to the dealer for service and repair. The current 5 year/ 50,000 mile emissions warranty provisions of the Act imply that additional "free" work is possible on certain parts. The owner will continue to return the car to the dealer with the hope or expectation that the work will be covered by the warranty, even where the owner's service problem is not covered by the warranty.

This emissions warranty is not a free consumer benefit, as projected liabilities are calculated into the sticker price of a new car by the manufacturer. Moreover, the consumer continues to pay for it when he has other repairs performed by the dealer. Survey after survey has concluded that repairs are less expensive and consumer complaints are much fewer when the work is performed by the independent aftermarket.

In March 1980 the Director of the Bureau of Competition of the Federal Trade Commission stated:

> Congress, the FTC, the Department of Justice and the affected independent aftermarket firms agree that a five year emission warranty will divert business from the independent sector to franchised car dealers. This will force many small businesses to leave the aftermarket industry and could result in higher repair prices and inconvenience for consumers.

Comments of the Bureau of Competition Federal Trade Commission Regarding California Automobile Emission Control System Warranty Regulations, March 3, 1980 at 7.

It is strange that small business is not given an opportunity to compete for this business, but instead has been legislated out of the marketplace. Small business is not asking for any subsidies, but just wants an opportunity to compete on an equal basis in the repair market.

I urge the Committee to adopt a report strongly recommending that Congress amend the Clean Air Act to reduce the mandatory warranties on emission-related automotive components from 5 years/50,000 miles to 2 years/ 24,000 miles. Legislation such as H.R. 4960, the bill proposed last year to amend the Clean Air Act, could restore competition to the automotive aftermarket to the benefit of consumer and small business.

I wish to thank you, Mr. Chairman, and members of the Committee for this opportunity to present the views of the Automotive Warehouse Distributors Association.

PRINTING INDUSTRIES OF AMERICA, INC.

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Government Affairs
Department

TESTIMONY OF
THE PRINTING INDUSTRIES OF AMERICA
AND
THE NATIONAL ASSOCIATION OF PRINTERS AND LITHOGRAPHERS
BEFORE THE
SENATE SMALL BUSINESS COMMITTEE
ON
LEGISLATIVE PRIORITIES FOR THE 99TH CONGRESS

FEBRUARY 6, 1985

For Additional Information Contact:

Benjamin Y. Cooper
Senior Vice President
Government Affairs

The Printing Industries of America, Inc. (PIA) appreciates the opportunity to appear before the Senate Small Business Committee to present our legislative priorities for the 99th Congress. Our comments today are on behalf of PIA's 12,000 member companies as well as the 3,000 members of the National Association of Printers and Lithographers (NAPL).

The printing industry is clearly a small business industry. There are more than 50,000 printing companies in the United States with an average size of fewer than 25 employees. While printing is the nation's seventh largest manufacturing industry, it is the largest in terms of number of establishments.

Like most entrepreneurs, printers share the frustrations of trying to train and retain skilled employees. Finding good employees and then keeping them satisfied is a challenging job in an industry that is facing a growing shortage of skilled labor in many areas of the country.

A vital component in allowing employers to cope successfully with this growing labor shortage is the tax-favored status of a broad range of employee fringe benefits. A very high percentage of printers in the United States provide a significant level of benefits for employees including health and pension care, employee stock ownership, educational assistance and many others. The tax-favored status of these programs allows employers in our industry to remain competitive and to continue to attract new people to printing and the graphic arts.

The current employer-sponsored benefit plans, together with social security and related programs, allow today's workers to enjoy an unprecedented degree of financial security. Action now to increase taxes on employee benefit programs would have a detrimental affect on the financial security of millions of Americans. Yet as the 99th Congress begins, the Reagan administration is considering a range of tax increases many of which will directly affect previously tax-favored employee benefits.

Workers at lower income levels benefit the most from the tax advantages accorded employee benefits. The lowest paid workers would be the least likely to be able to purchase health protection on their own and the most likely to require public support in the event of catastrophic illness. The middle class worker would also suffer. Since the cost of health insurance varies by geography, occupation and age, taxing it would unfairly penalize older workers who tend to use the health care system more frequently, as well as those in high-cost medical areas and in high-risk jobs.

It is not simply tax-favored health and pension coverage that concerns the printing industry. Education assistance, child-care, 401(k) plans, and other benefits are targetted for cutbacks under the administration's tax plan. The ability of an employer to provide workers with programs like these is more than a benefit, it is a business investment. Helping an employee obtain an advanced degree or cope with the demands of child-care comes not from benevolence, but from the recognition that doing so will help develop a more productive and stable workforce. Treating such programs as income, which is taxable, instead of business investment, which is tax-favored would be a mistake of tragic consequences.

PIA and NAPL urge this committee to take a strong stand against the erosion of tax-favored employee benefits.

A related issue of great interest to our industry concerns the new auto-recordkeeping requirements for mixed-use vehicles. I think it is safe to assume that the committee is aware of the small business community's general reaction to the new regulations. I will only add that PIA and NAPL have launched an active lobbying campaign aimed at repealing section 179(b) of the tax code. We urge the members of this committee to join us in that effort.

Another major issue that PIA will devote considerable time to this Congress is our continuing effort to allow federal contractors the option of utilizing compressed and flexible work schedules. Under the current provisions of the Walsh-Healey Act, federal contractors performing on contracts over $10,000 are required to pay their employees overtime when they work beyond eight hours per day or forty hours per week. This contrasts with the Fair Labor Standards Act which requires the payment of overtime for all work beyond forty hours per week, with no daily overtime provisions.

The result of the differing requirements in the two laws is that contractors performing work on private contracts are using alternative work schedules in increasing numbers while federal contractors are effectively prohibited from taking advantage of these new work-scheduling techniques. I say effectively prevented because while a printer performing on a Government Printing Office contract could use a four day, ten hour schedule, the overtime costs involved in such a schedule would have likely prevented the printer from winning the competitive bid in the first place.

Since American businesses began to use alternative work schedules approximately 15 years ago, over 9.5 million full-time workers in the U.S. now enjoy flexible and compressed workweeks. These numbers include both public and private sector workforces. Thirty-three state governments have compressed workweek programs while virtually every state government is utilizing some form of flexitime in various departments and agencies.

Even the federal government has recognized the advantages that can be obtained from alternative work schedules. As a result of an experimental program that was initiated in 1978 and extended in 1982, over half a million federal workers, almost one quarter of the federal work force, now enjoy some form of flexible or compressed work schedule.

Studies conducted of both private sector and government alternative work schedule programs indicate a high degree of employee acceptance of these schedules. In fact, the impetus for experimenting with such schedules often comes from the workers. Both management and labor agree that regardless of who initiates the idea, a variety of benefits are realized from the use of alternative work schedules. These include: increased productivity and better utilization of plant and equipment; greater employee satisfaction due to increased leisure time; and reduced commuter costs.

According to the Work in America Institute, alternative work schedules will be used by over 25 percent of the workforce, more than 30 million Americans, by the end of the decade. If you assume, for the sake of argument, that no changes will have been made in the Walsh-Healey Act by then, you will find in 1990 that the employers of more than 30 million Americans will be excluded from the federal contracting process

Legislation will soon be introduced in the Senate to conform the overtime provisions of the Walsh-Healey Act with those of the Fair Labor Standards Act. PIA and NAPL urge all the members of the Small Business Committee to fully support this effort.

A fourth major small business issue we will be bringing to the congress is the ongoing efforts of the Office of Management and Budget and the Government Printing Office to close and consolidate a number of inefficient federal agency printing facilities.

Under Title 44 of the U.S. Code, the GPO, a legislative branch agency, has the primary responsibility to meet the federal government's printing requirements. The GPO, acting as the government's printer, will work with the customer agencies to either produce the agencies printing requirements in-house or to contract that work out to private industry.

On average, the GPO contracts-out over 70 percent of the work that is brought to it. Over 93 percent of that work goes to small businesses. With over 8,000 printers competing regularly for over $600 million in GPO contracts, the GPO has the distinction of operating the most effective small business procurement program in the federal government.

In spite of GPO's primary role in the production of the federal government's printing, the federal agencies over the years have established many of their own in-house printing facilities in an attempt to "meet the mission" of their respective agencies. Today there are over 1,000 federal printing plants competing with our industry.

Ongoing efforts at OMB and GPO to identify agency printing facilities has resulted in the targetting of over 160 printing plants for either consolidation or closure. In reviewing federal plants around the country OMB and GPO found case after case of production costs way out of line with what was easily obtainable by contracting-out the work through the GPO.

The review compared factors at the agency plants such as percentages of labor costs to total costs, the cost of producing 1000 sheets of black and white 8 1/2" x 11" copy, etc. The results of surveying over 1000 agency plants were very surprising. Over 160 plants were identified that failed to meet even the minimum requirements of efficiency. One facility had a percentage of labor costs to total costs that was more than double the industry average. Another produced 1000 printed sheets at a cost more than three and one-half times that which you or I could get at virtually any printer.

Not only did the review find that costs were out of line, but there is a tremendous duplication of effort as well. The Navy operates eight printing and duplicating facilities in Charleston, SC. The Department of Agriculture operates eight plants in Montana, two of which are located in Missoula, which has a population of only 34,000. The list goes on.

Clearly this entire issue is one that is ripe for congressional oversight. The Joint Committee on Printing, which has jurisdiction over the GPO does not conduct oversight hearings on federal agencies. While the OMB/GPO effort has identified many plants for closure, many agencies continue to display intransigence and a callous disregard for the thrust of the review effort.

While I mentioned that the GPO operates the finest small business procurement program in the federal government, not a single day of hearings has ever been held in either the Senate or House Small Business Committees to examine any aspect of that program. Efforts to close agency printing facilities could potentially result in hundreds of millions of dollars in increased contracting opportunities for the printing and graphic arts industry, at a tremendous savings to the government. But these efforts need to be backed up by Congressional pressure on the agencies to follow-through with the OMB/GPO recommendations.

Specifically, Congress should include detailed instructions in agency budgets, requiring them to meet the savings targets outlined by OMB or risk the loss of funding in other areas. While pushing for the elimination of unnecessary facilities, Congress should impose a government-wide freeze on the purchase of new printing equipment until a thorough review of agency requirements can be conducted. It makes little sense for the Department of Energy to invest in hundreds of thousands of dollars in new printing equipment when the Department of Agriculture is putting similar equipment on the auction block. This committee can help move that effort forward and the printing industry would like to work with you to accomplish that.

Thank you for giving me the opportunity to appear today.

American Council of Independent Laboratories, Inc.
1725 K Street N.W. Washington DC 20006

TESTIMONY OF
THE AMERICAN COUNCIL OF INDEPENDENT LABORATORIES
AND
THE BUSINESS COALITION FOR FAIR COMPETITION
BEFORE THE
SENATE SMALL BUSINESS COMMITTEE
ON
LEGISLATIVE PRIORITIES FOR THE 99TH CONGRESS
FEBRUARY 6, 1985

For Additional Information Contact:

Joseph F. O'Neil
Executive Director

My name is Joseph O'Neil, and I am here today in two capacities. I am Executive Director of the American Council of Independent Laboratories and Chairman of the Business Coalition for Fair Competition. Both of these organizations have concerns that I think are appropriate for consideration by the Senate Small Business Committee.

First, the issues of the American Council of Independent Laboratories (ACIL). ACIL is a trade association representing the independent, tax-paying testing, analytical and research and development laboratories of the United States. Most of these laboratories provide services in the areas of chemical analyses and construction materials engineering and testing. More than 90 percent of these firms are small businesses.

The following are matters of major concern to this association:

1. ACIL is disturbed by the proposal to eliminate the Small Business Administration. We believe there must be an agency to promote and protect the interests of small business. On the other hand, we would support efforts of this committee to strengthen and improve the programs of SBA. Special praise is due the SBA Office of Advocacy, which has been an able and

dedicated ally of small business, as this committee realizes. ACIL would strongly oppose any attempt to weaken the Office of Advocacy.

2. The Second White House Conference on Small Business is a major priority for ACIL and for the entire small business community. We urge this committee to do all it can to prod the Administration to begin devoting the necessary attention to preparations for this Conference. To date, there has been neither leadership nor direction from the White House; both are needed promptly. We also recommend that control and management of the White House Conference on Small Business be placed in the hands of the SBA Office of Advocacy, where it properly belongs.

3. There are several procurement matters of concern to the ACIL membership:

- The current SBA Size Standard for commercial testing laboratories is too low (annual gross of $3.5 million). It is totally inconsistent with the standard for R&D/Testing laboratories (500 employees). There is no basis for this difference; many of our members do substantial amounts of work in both areas. ACIL still is convinced that a several-tiered size standard, which was recommended by the delegates to the first White House Conference on Small Business in 1980, is the fairest and most practical type of size standard. We have tried on several occasions to convince SBA of the inadequacy of the size standard for commercial testing laboratories, to no avail. We would welcome this committee's assistance in our future efforts.

- The Federal Acquisition Regulation's (FAR) "rule of two", when combined with the flawed size standard for commercial testing laboratories, totally eliminates from the Federal marketplace many of the best and most qualified independent laboratories. Not only is this unfair to these laboratories; it is also a serious loss to the Government and the U.S. taxpayer. The "rule of two" must be modified, because it excessively emphasizes the size of the contractor to the almost total neglect of the quality of his product or service. ACIL recommends a common-sense approach to small busines set-asides, that is fair to all segments of the business community. One good example is the approach used by EPA in its contracts for testing and analytical services in support of "Superfund" work. When drawing up an IFB for these laboratory services, EPA earmarks 50% of the work for small business set-asides; on the other 50% it allows unrestricted bidding.

- A final procurement issue concerns criteria for selection of professional services firms, like testing laboratories. In far too many Government procurements, price is the only consideration. ACIL believes strongly that price should be secondary to quality. Proven competence should be required of testing firms and other professional and technical service companies that do business with the Government. The example of agencies like EPA and FDA, which have certification/accreditation requirements for testing laboratories with which they contract, should be followed by all Federal agencies and departments.

4. In recent months, no single Government issue has upset the independent laboratory community more than the IRS law regarding company vehicles. I just returned from an ACIL meeting in Texas, where the subject of these regulations and how to cope with them was on every member's lips. These regulations impose massive and expensive recordkeeping requirements on the employer. And they have already hurt employee morale in some companies. Finally, even from the IRS perspective, their value is questionable. One of our members said that he has done careful calculation of the impact of the regulations on his company. He estimates that it is going to cost his firm $60,000 in 1985 to comply with the IRS requirements and that the tax yield to IRS will be less than $20,000. Given the corporate tax rate and the loss in company profits, both his company and the IRS will be losers. ACIL urges the Senate Small Business Committee to take action to correct this mistaken IRS policy.

I am also testifying on behalf of the Business Coalition for Fair Competition (BCFC). More than 20 national associations, representing hundreds of thousands of small businesses, participate in BCFC. The issue of concern to all of us is commercial activity by nonprofit entities, activity that is in competition with tax-paying small businesses.

ACIL has been wrestling with this problem for nearly 50 years. Our eyes were opened at the first White House Conference on Small Business in 1980, when we came in contact with representatives from many other sectors of the small business community who were having trouble with the same problem. Indicative of this is the fact that three of the recommendations to Congress emanating from that Conference dealt with Government competition with small business, both direct and indirect (from nonprofits).

In the aftermath of the Conference, several of us got together and decided that, because nonprofit competition was an issue for so many associations, the problem should be addressed by a coalition. In early 1983, the Business Coalition for Fair Competition was established.

BCFC's basic premise is that competition in the marketplace should be fair. That is, the playing field should be level and all competitors should bear the same basic burdens. That is not true when a "commercial nonprofit" competes with a tax-paying small business. Usually, the nonprofit does not pay taxes on its revenues; the small business does. When doing direct-mail marketing, the nonprofit enjoys discounted postal rates not available to its small-business competitor. And in various states, other advantages accrue to the nonprofit.

In 1950, the Congress adopted the IRS Unrelated Business Income tax for nonprofits, with the main purpose of equalizing competition between nonprofit organizations and for-profit businesses. The resounding message to the Senate Small Business Committee from BCFC and its hundreds of thousands of small businesses is - the UBI regulations are not working. The competition is not equal. Further, the incidence of commercial activity by nonprofits is increasing dramatically. The bottom line - the U.S. small business community is being seriously disadvantaged.

At this point, let me state clearly that BCFC is not opposed to nonprofits and has no desire to detract from their legitimate roles and their important contributions. In fact, here is a quote from BCFC's introductory brochure:

> While pursuing equitable competition, BCFC acknowledges the importance of the independent nonprofit sector and its vital contributions in education, basic research, charitable and other traditional tax-exempt endeavors. As our economy requires increasing numbers of highly trained engineering, scientific and other technical and professional personnel, universities face an ever greater challenge in educationg workers for the jobs of the future. Likewise, nonprofit organizations are needed to undertake basic research if the United States is to preserve and build its competitive position in emerging technologies. Valuable human resources and equipment must not be diverted from these fundamental tasks to

> commercial activities, or the nation will be a loser. BCFC believes that measures denoting the proper roles of the independent nonprofit sector and the innovative tax-paying sector are crucial.

Because so many small businesses are harmed by this unfair competition, BCFC believes the Senate Small Business Committee should be concerned about the problem. Research is needed to determine exactly how extensive commercial activity by nonprofits is, how rapidly it is increasing, how much revenue is being lost by the U.S. Treasury, and how much damage is being done to the small business community. And reasonable remedies - fair to both small business and the nonprofit community - must be found.

We encourage this committee to make nonprofit competition a priority issue during the 99th Congress. And we welcome the opportunity to work with the committee staff and with representatives of the nonprofit community in pursuit of such remedies.

Thank you for giving us this opportunity to present our views. I will be submitting a written statement of my presentation within the alloted two-week period. And, now, I will be happy to answer any questions that you might have.

# # #

National Society of Public Accountants

The National Society of Public Accountants

Testimony Before

The United State Senate

Committee on Small Business

February 6, 1985

1010 N. Fairfax Street, Alexandria, Virginia 22314 (703) 549-6400

Thank you, Mr. Chairman.

My name is Robert Grille. I am the President of the National Society of Public Accountants and the Past President of the Accountants Society of Virginia. I am enrolled to practice before the Internal Revenue Service and I am accredited by the Accreditation Council for Accountancy in both accountancy and taxation.

The National Society of Public Accountants (NSPA) consists of 17,000 individual practicing professional accountants throughout the United States. NSPA has an affiliated state organization in each of the fifty states, the District of Columbia and the Commonwealth of Puerto Rico. Our members provide auditing, accounting, tax and management advisory services to more than four million small businesses and small government entities throughout the nation.

As accountants, and small business people ourselves, we are in a unique position to understand the problems of small businesses. That is why we appreciate this opportunity to be here today. What I would like to do is briefly review those problems which we believe are of greatest concern to small businesses and into which we have particular insight.

One of the problems faced by small businesses that members of NSPA are particularly aware of is the difficulty they have with Internal Revenue Service (IRS) compliance procedures. These difficulties are not the result of a single problem with a simple solution. NSPA would like to take this time to address those tax compliance problems we consider to be the most troublesome and for which we think solutions are imperative.

One of the major problems small businesses face as they attempt to comply with the IRS is the accelerated pace of tax legislation. No longer does Congress pass comprehensive tax bills every three to five years. These tax bills are now being passed every other year, and sometimes more often.

In the last 15 years, there have been approximately 20 major tax bills enacted. The massive scope and sheer volume of recent tax law changes defy comprehension by the most sophisticated small business person. Even tax professionals are bewildered by the increasing velocity of tax law changes.

The Treasury Department has been unable to keep up with the pace of tax legislation. It has yet to issue regulations on many Internal Revenue Code (IRC) Sections for which guidance is sorely needed and the regulation projects that now need to be undertaken as a result of the Tax Reform Act of 1984 only add to the burden. Business planning is difficult when details of a law are not interpreted for a considerable amount of time after the enactment of a law.

Until regulations are published, tax preparers and their small business clients are left to their own interpretations. These interpretations often conflict with the final regulations - resulting in penalties for clients and preparers.

In an effort to increase compliance, Congress has increased the number of penalty provisions. This, in and of itself, creates a second major problem. As tax professionals, it appears to us that penalties are now being used as a revenue raising vehicle. According to the 1983 Annual Report of the Commissioner of the Internal Revenue Service, 25 million penalties were assessed during that single year. Taxpayers find the continued threat of penalties objectionable.

Congress has also passed legislation that allows the IRS to impose penalties far in excess of the infraction that has been committed. For example, Section 6652 of the Code allows IRS to impose a $50 fine on a business for each failure to file an information return on payments of $600 or more to an independent contractor - up to a maximum penalty of $50,000 per calendar year. Not only does the filing of these returns impose a tremendous paperwork and financial burden on small businesses, but the penalty is excessive, especially in light of the fact that these are information returns only. These returns do not require the person filing to pay any tax. The business community perceives this penalty to be unjust. There are many other penalties that are perceived to be equally excessive and unfair.

Unjustified penalties are a further problem. IRS frequently takes the position that a penalty is due even before a deficiency is established. It is very difficult, for example, for a small businessperson to understand why he receives a letter from IRS stating that a penalty is due for late filing, or for non-receipt of payment, when the businessperson has a cancelled check in hand timely paid and properly endorsed by IRS. To say that the businessperson or his tax preparer can simply contact the IRS to straighten out the problem ignores the fact that many taxpayers are terrified of the IRS. When they receive a notice of a deficiency, many taxpayers just pay the peanlty without stopping to see if it is proper. This generation of fear of a government agency that supposedly operates as a servant of the people is unconscionable.

While we believe that the problems mentioned so far contribute to the overall problem of compliance, one other cause, we believe, of noncompliance by many individuals and small businesses stems from the attitude of many IRS agents. The Service should adopt a less adversarial stance with taxpayers. The Service's attitude leads to a feeling by taxpayers that they are being unfairly treated and diminishes the desire to comply. Greater attention to public relations and public education could go a long way towards alleviating this problem. More direct contact with and responsibility to the taxpaying public would solve some of the problems that exist in the IRS.

NSPA has recommended that there be a five year moratorium during which time no additional substantive income tax laws may be enacted and all current laws would be frozen. As we have already stated, the accelerated pace has led to confusion and an honest inability to comply by individuals and businesses. We believe everyone - businesspeople, individuals, members of Congress, the IRS, lawyers, and tax practitioners - could benefit from a moratorium on changes in the Code.

It is further recommended that, at the start of this moratorium, a Commission be established to review the current tax system and offer proposals on its reforms. Members of the Commission should be chosen from the Executive and legislative branches of government, the accounting and legal professions, the business community, and the general public. The Commission, which would serve for five years, would submit its report to the President and to Congress at the end of three years. It would then work with Congress and the Administration during the remainder of its existence to implement its proposals.

NSPA urges congressional support for continuing legislative efforts to repeal Section 179 (b) and (c) of the Tax Reform Act of 1984. These provisions impose massive new record keeping requirements on businesses for their use of automobiles and other personal property. They also impose accompanying tax preparer penalty provisions.

While the IRS has indicated that it will ease the regulations it originally proposed, the announced changes do not appear to address all of the concerns of small business. The record keeping requirements still impose a tremendous paperwork burden. Further, small businesses will still have difficulty understanding the requirements and affording the costs of added record keeping.

These paper-generating provisions interrupt normal business operations and are unlikely to result in an appreciable increase in tax revenues. Treasury estimates of $105 million in increased revenues in fiscal year 1985 are doubtful as it is already illegal to deduct for the personal use of such items as automobiles and computers. In addition, this revenue estimate must be considered in light of what it will cost small businesses to comply with these requirements. A conservative estimate of $500 a year for each of the nation's 14 million small businesses would indicate a cost of close to $7 billion for this segment of the business community alone.

As accountants, NSPA's members are personally concerned by the fact that, once again, tax preparers are being asked to do the work of the IRS. What will a member of the Society do when a client refuses to sign the letter verifying his or her records? Most likely, watch that client go to an unscrupulous tax preparer who won't require the verification. And what real protection will the accountant have if the client signs the letter but still fails to keep contemporaneous records? It won't be long before the IRS asks Congress to impose a penalty for that - something the accountant has no control over.

Small business people do not object to fair taxation, but they strongly object to excessive and unnecessary record keeping requirements. Accountants do not object to fair penalties for their failure, or their client's failure, to comply with the Internal Revenue Code; but they do object to the imposition of penalties for something they cannot control. It is for these reasons that NSPA continues to strongly urge a total repeal of Section 179 (b) and (c) of the Tax

Reform Act of 1984.

Continuing on the subject of taxation and the IRS, NSPA is concerned about IRS Notice 707 and the accompanying Revenue Procedure 84-63 which requires taxpayers to use magnetic media to file information returns reporting payments of interest, dividends, or patronage dividends made after December 31, 1983 to more than 50 payees. Implementation of this requirement will cause an undue hardship and severe financial burden for many small business people who do not have the computer ability to produce magnetic media to satisfy the IRS requirement.

The cost of this requirement to small business will be astronomical. Large businesses have the ability to produce magnetic media to meet IRS requirements at no appreciable increase in cost to them. Most small businesses do not.

While Revenue Procedure 84-63 provides for a waiver, upon request by the filer, for undue hardship, it is limited to one year, if it is granted. The filer must reapply for each succeeding year that a waiver is needed. NSPA believes that there should be a continuing or one-time waiver until the filer has magnetic media abilities. Since the waiver is discretionary with the Service Center Coordinator, there should be an appeals procedure when the taxpayer feels that his waiver has been arbitrarily rejected. A better solution would be to exempt small businesses from this requirement or to impose the requirement only on filers of more than 500 documents rather than 50.

The next item on NSPA's agenda is one we do not really need to raise before this Committee. The Senate Small Business Committee certainly does not need to be told how important small businesses are to our country's economy. You already know that small businesses produce more jobs than large businesses do, that half of those employed are employed in small business, that small business expansion was a major catalyst for the recent economic recovery, that small businesses provide the majority of jobs for the young, the old and the part-time employees as well as for the cyclically unemployed. You already know this and more.

To suggest the abolition of the Small Business Administration (SBA) is to foster the impression that this Administration and this Congress are not concerned about the needs of the small business community. To follow through with this suggestion is to imply that the small business community is not as important as other "constituencies". I cannot believe that this is the impression Congress and the Administration intends to give.

Th SBA is more than just a focal point for the small business community, although this in and of itself is an important service. More importantly, the SBA is the only agency created specifically to assist, counsel, and champion America's small businesses. While other federal agencies provide services to small businesses, only the SBA has the provision of service to small businesses as its only responsibility.

NSPA believes the SBA provides many valuable services. The Office of Advocacy has worked with other federal agencies to reduce the paperwork burden on small businesses and to develop regulations that take the needs of small businesses into consideration. The Office of Advocacy has also worked to open procurement opportunities up to small businesses - thereby helping these businesses to grow while insuring that federal purchases are as cost effective as possible.

In addition to the Office of Advocacy, the SBA offers many other programs. One that NSPA's members are particularly involved with is the agency's management assistance program which provides a full range of services - training, counseling, and information. In addition to seminars and conferences, the SBA can arrange for individual couneling in such areas as marketing, buying, producing, record keeping, financial management, financing, and administration. The counseling is provided through such programs as SCORE (Service Corp of Retired Executives) and ACE (Active Corp of Engineers). NSPA works with the SBA to help provide such counseling under the technical agreement the Society signed with the Agency in 1976 and renewed in 1982. Under the agreement, the Society's members agree to provide no cost counseling in the area of taxation and financial planning to those small businesses that the agency refers to them.

The National Society is, however, aware of the valid criticisms many have of the SBA. At a meeting this past weekend, members of the Society told of loans their clients applied for that came through too late to be of assistance and of counseling that was not available.

After much discussion, the members of NSPA recognized the need for an independent federal agency to protect and promote the vital interests of small businesses. The Society's members believe, however, that Congress should mandate a comprehensive review of all SBA programs to assess their efficiency and their appropriateness to the broad needs of the small business community. We believe that review should be conducted under the direction of the private sector. The Society further believes that in its delivery of lending and management assistance service, the SBA should be directed to increase its reliance on the local resources within the private sector that have expertise in various program areas.

The National Society, as I have said, favors the continuation of the SBA but urges that its mission be redirected so that it may better represent and serve the interests of truly small businesses.

Another concern for the Society is the continuing effort of the Federal Trade Commission (FTC) in seeking reauthorization. The FTC is important to the independent public accountant because it has unique strengths and resources not found in the states for insuring free competition among professionals.

In recent years, the FTC has exercised its jurisdiction to prevent unfair methods of competition and deceptive acts and practices by professionals who violate statutes administered by the Commission.

NSPA applauds these efforts by the FTC and urges their continuance.

It is vitally important that the FTC be allowed to continue these efforts. While the state regulatory bodies should set the standards of qualifications an individual must possess to practice in that state, professionals need a place they can turn to if the standards are set in such a way as to unfairly restrict competition.

Unfortunately, many of the state regulatory bodies are controlled by those they seek to regulate. NSPA has complained for years about the powers of state accountancy boards to restrict the performance of various accounting functions by unlicensed accountants. For example, NSPA has always agreed that the attest, or certification, function should be regulated. In the past five or six years, however, we have witnessed efforts by the American Institute of Certified Public Accountants and the National Association of State Boards of Accountancy to enlarge the definition of the attest function to include compilation and review reports. Both of these reports are based on unaudited financial statements that express no opinion. Drastically limiting the number of accountants who may legally prepare a compilation and review report deprives the small business customer of the accounting services they need at a reasonable cost. Accountants affected by these restrictions need to know that they have a place to go for assistance when these restrictions go beyond the scope of regulations for the public good and into the scope of regulations for a segment of the professions good.

NSPA is also concerned about the question of legislative veto as it affects the FTC. It seems only logical to us that provisions be made for a limited delay in the effective date of FTC rules while Congress has the opportunity to review the proposed rule. Such a rule could then be vetoed with the concurrance of both Chambers and the President's signature. To provide that a rule would not become effective until they are affirmatively enacted by Congress and signed by the President would prevent the FTC from being able to protect consumers and to preserve competition.

NSPA urges Congress to reject any effort to exempt professionals from the FTC's authority and to provide for a legislative veto based on common sense when the Commission is reauthorized.

One final issue that NSPA would like to briefly raise is one we discussed at length during hearings before this Committee's Government Regulation and Paperwork Subcommittee in November, 1983. At that time, we reported on the work we have done with the Bureau of the Census and the Internal Revenue Service to reduce the paperwork burden imposed on businesses.

It cannot be denied that the 1982 Economic Census achieved a milestone in drastically reducing the paperwork burden and the Bureau is continuing that work in preparation for 1987. However, as significant as these improvements are, we believe there is room for improvement.

Accountants fill out the bulk of the economic census forms. Nothing irritates them more than the due date of February 15. The overworked accountant does not need non-tax filing deadlines during the busy tax season. While the Census Bureau is liberal in granting extensions for submitting forms, the extension itself generates paperwork, and, even then, the extension is only until May 15 A due date of June 15 or even August 15 would be more realistic. The August 15 date would also fit in with the extension date allowed by the IRS to individuals.

The law under which the Census Bureau collects the economic census data specifies the collection of calendar year data. The suggestion has been made by others that the collection year should be a fiscal one rather than a calendar one. While a fiscal year census would certainly avoid the bunching up of reporting dates, NSPA does not believe it would not be feasible for the bulk of small businesses, most of whom report on a calendar year. Such a change would be feasible only if the small business were to report on its activities in the year prior to the census.

One other aspect of the paperwork burden that I would like to briefly discuss, concerns the Internal Revenue Service. NSPA has worked with the IRS in offering suggestions on how they can improve their forms. It is not my purpose today to go into a long discussion about this but rather to make a few comments about one way to further reduce the paperwork burden of income tax forms.

Since it is the duty of the Federal government to collect, correlate, and disseminate data that will assist the decision and policy making process of both the government and private sector, then I would suggest that the information be extracted as painlessly as possible by making some of the changes I have suggested here today. While none of us expect to see the paperwork burden eliminated during our lifetime, efforts are underway to at least reduce the undue paperwork burdens on small businesses. The National Society of Public Accountants looks forward to continuing to work with the Bureau of the Census and the Internal Revenue Service to help make the Paperwork Reduction Act really work for small business.

This concludes my comments for today. I would be happy to answer your questions on these topics or on any others that you feel I can lend my professional expertise to.

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STATEMENT

OF

LONNIE F. HOLLINGSWORTH, P.D.

CHAIRMAN, EXECUTIVE COMMITTEE

THE NATIONAL ASSOCIATION OF RETAIL DRUGGISTS

BEFORE THE

COMMITTEE ON SMALL BUSINESS

U. S. SENATE

ON

SMALL BUSINESS PRIORITIES FOR THE 99TH CONGRESS

99TH CONGRESS

February 6, 1985

Statement of Mr. Lonnie F. Hollingsworth
Before the Committee on Small Business
U.S. Senate

February 6, 1985

INDEPENDENT PHARMACY'S PRIORITIES FOR THE 99TH CONGRESS

Mr. Chairman, Members of the Committee:

I am Lonnie F. Hollingsworth. I serve as Executive Committee Chairman of the National Association of Retail Druggists and as Chairman of the NARD National Legislation and Government Affairs Committee.

The National Association of Retail Druggists (NARD) represents owners of more than 30,000 independent pharmacies, where over 75,000 pharmacists dispense more than 70 percent of the nation's prescription drugs. Together, they serve 18 million persons daily and provide nearly 90 percent of the Medicaid pharmaceutical services. NARD has long been acknowledged as the sole advocate for this vital component of the free enterprise system.

NARD members are primarily family businesses. They have roots in America's communities. The neighborhood independent druggist typifies the reliability, stability yet adventuresomeness that has made our country great.

As owners of independent pharmacies, our members are committed to legislative and regulatory initiatives designed to provide them a fair chance to compete. We especially appreciate the opportunity to appear before the Committee to present testimony on NARD's small business priorities for the 99th Congress. We would like to express our special appreciation to the Committee, Chairman Weicker, Senator Bumpers and staff for the extraordinary cooperation that you have shown NARD in the planning of this important hearing.

The independent community pharmacist of today is simultaneously a health care professional and a small businessperson. NARD and its members vigorously support the American free enterprise system which provides the only meaningful climate under which a small business can economically survive, have the opportunity to succeed through personal efforts, and perform an important and essential service to the community.

The elimination of unfair competition with independent pharmacies is an essential component of our agenda for the 99th Congress. Especially obnoxious is unfair government competition It is our position that no small business should tolerate a government allocation of their taxes for projects or programs that unfairly compete with the very sources of the tax revenue: business generated by enterprising independent retail pharmacists.

The Veterans Administration's prescription drug program, which denies veterans the freedom to choose a convenient independent retail pharmacy to provide their pharmaceutical services and products, is a glaring example of such government competition. We urge the Senate to support legislation such as that introduced by Congressman Hammerschmidt which would provide freedom of choice and provide the veterans the quality of services to which they are entitled. After all, welfare recipients are guaranteed such freedoms.

Equally insidious unfair competition in the private sector is high on NARD's agenda for the new Congress. In the strongest possible terms, our members urge the Committee to do all within its power to improve the enforcement of price discrimination and other antitrust laws by both the Federal Trade Commission and the Department of Justice. Of special concern is unfair competition from the sale of prescription drugs by private non-profit hospital pharmacies to non-hospitalized patients.

We urge the Committee to consider oversight hearings on the enforcement of the Portland Retail Druggists case which held that pharmacies could not use the Non-profit Institution Act as a shield from the Robinson-Patman Act and the landmark Jefferson County decision concurring with NARD's position that the price discrimination practices of the Robinson-Patman Act extended to the sale of pharmaceutical services and products to state and local government pharmacies for resale in competition with NARD members.

We urge the Committee to consider earmarking of FTC and Justice Department budgets for enforcement of Robinson-Patman as well as vigorous oversight.

We pledge to assist the Committee in accompanying any of the following objectives in the 99th Congress:

- To prevent federal officials employed by the Health and Human Services Department at the regional level, primarily Region VI, who attempted to eliminate discounts earned by retail pharmacists who participate in the Medicaid Program.

To support, instead, a direct payment or prescription voucher for the Medicaid Program which will significantly reduce excessive program overhead and eliminate delay in payments to pharmacy providers.

- Support the repeal of contemporaneous records for verifying motor vehicle tax deductions as an unnecessary paperwork burden that falls most heavily on the smallest of small businesses.
- Support the extension of the Equal Access to Justice Legislation which permits small businesses to recover legal fees from the government if the small business prevailed in a legal action with the government and if the government could not prove that its action was not justified. NARD supports reauthorization with a provision which covers government liability for the underlying action which led to the formal action against small businesses which was vetoed by President Reagan.
- To assure the full implementation of the Pharmacy Crime Legislation (PL98-305). The 1980 hearings this Committee held on this subject was vital to the strong interest eventually expressed four years later by the Senate. We hoped that the Committee would review the failure of the Department of Justice to fully implement the new law.
- To assure that any legislation regarding the subject of preferred provider organizations or health maintenance

organizations is drafted so that independent retail pharmacy be provided equal opportunity to participate in any new form of health care delivery (see SBLC health care cost containment resolution encouraging open competition in the sale of drugs and other services).

- Support legislation to clarify provisions of the antitrust laws that have long prohibited predatory pricing practices but have lacked clear and understandable guidelines to identify illegal anti-competitive predation. Independent retail pharmacists, consumers, as well as the industry as a whole will benefit from a clear standard of fair competition.
- Support legislation which would establish a limited exemption from the antitrust laws to permit community pharmacists to collectively negotiate with third party program administrators and sponsors. Independent pharmacists want an opportunity to compete and earn a fair profit for their services and profits. We suggest that the committee review the 1973 report and recommendations of the House Small Business Committee on this matter as well as S.379, the Health Cost Containment Act of 1985, which would be an appropriate vehicle to obtain our objective.
- The establishment of a new category of drugs to be known as pharmacist legend. This interim class

of drugs would assist in determining whether labeling alone will adequately protect the public; would substantially reduce patient expenses involved in obtaining prescription drugs and would enhance consumer convenience. These select products would not be out on the open shelf but would be available only with pharmacist consultation. It is hoped that the confusion and health hazards associated with recent promiscious switches from Rx to OTC status, notably in the instance of metaproterenol, would be significantly reduced. Likewise, adding "pharmacist" to the label and labeling of OTC drugs would refer the consumer to the most readily accessible source of information about drug interactions, precautious side effects, contraindications, and related concerns.

- To support legislation to help assure that independent retail pharmacists know whether or not a prescription drug has received FDA approval and therefore can act accordingly to protect the public. Appropriate legislation passed the House in the 98th Congress.
- To revise the labor laws reinstating the youth differential minimum wage for youths 16 to 18.

- To support legislation to (1) establish a national policy of procuring commercial goods and services from the taxpaying private sector, and (2) to control indirect competition and commercial activities so as to provide that preferences such as tax exemption and postal rate discounts not be available to the comercially competitive activities of nonprofit and regulated industries.

In the regulatory area, the Regulatory Flexibility Act should be vigorously enforced to assure that unnecessary existing rules and regulations are eliminated and that new proposals, are assessed for impact on small business, such as independent pharmacies; and appropriate action such as modification or withdrawal as was the case with the ill-conceived proposed Patient Package Insert Program. The rules and regulations of the Health Care Financing Administration are recommended as a suitable target for Committee oversight hearings. Likewise, the burdensome IRS vehicle regulations reemphasize the need to include the IRS under the Regulatory Flexibility Act.

Our members are major factors in the stability of their hometowns. They are not newcomers or employees on the ladder to stardom in some distant chain's hierarchy. They know their employees and customers. Often they provide the success models or symbols to young, and not so young, of proof that the American dream of ownership and hard work is still what this country is all about. They support religious endeavors and other local institutions. In other words, they are leaders with a stake in the community who have, and are demonstrating daily, a commitment to local and national pride. They learned long ago that "big is not necessarily better!"

All that they epitomize is under fire. Regretfully, the Federal Government (through actions or inaction) is firing most of the shots!

Uppermost, our members want to continue owning and operating their pharmacies, providing vital, personalized health-care services for each of our communities. NARD solicits your assistance in any mutual effort which will permit them to continue to control their own economic and professional destinies.

Once again, Mr. Chairman, on behalf of the independent retail pharmacy, we thank you for the opportunity to assist the Senate Committee on Small Business in preparing its agenda for the 99th Congress.

ICIA The International Communications Industries Association
3150 SPRING STREET • FAIRFAX, VIRGINIA 22031-2399 • 703/273-7200

Senate Small Business Committee
February 6, 1985

STATEMENT BY
KENTON PATTIE
Senior Staff Vice President
International Communications Industries Association (ICIA)

We are very grateful to the committee and the committee staff for providing this excellent forum for the small business community. It provides the 800 small firms in my association with assurance that there are those in the Senate who are listening and who care.

Since last appearing before this committee, our name has been changed to International Communications Industries Association--a change that was needed to reflect the fact that our members are selling not only audio-visual products, but computer, video and other communications products.

Prompt Pay. It was in this room in 1981 that the first Senate meeting on prompt pay legislation was held, thanks to Senator Weicker, Senator Danforth, the majority and minority staffs and others who shared our concern about late federal payments.

Here we are four years later, on the eve of receiving the 2nd annual prompt pay report from the Office of Management and Budget based on the Prompt Payment Act of 1982 (Public Law 97-177). While there are still some problems to be worked out, the Act has been successful. The Reagan Administration has been very cooperative. The Office of Management and Budget has been committed to making the Act work. I am hopeful that the 2nd Annual Report due any day now will show what last year's report showed: that 99% of federal bills are now paid on time, compared to two-thirds being paid late before the law.

We recommend that during the 99th Congress there be an oversight hearing on the Act.

Further, we recommend that during the 99th Congress, the Act be amended to eliminate an extra 15-day grace period the government enjoys. This period means that the government has 45 days to pay its bills rather than 30.

Now that we know the Act works and that many agencies are regularly paying bills in 30 days, there is no longer a need for the extra 15 days.

In fact, that extra 15-day period was not in the original Senate bill which was written in this room. It was imposed on the House by a fearful executive branch. The fears have proved unfounded.

So, now its time to go back to the original Senate idea, which was a 30-day standard. Period. Why should the federal government enjoy a bonus 15-day grace period which is not available to the average U.S. citizen or business person?

I am pleased to report that following in your footsteps, 35 states have now adopted prompt pay laws. In addition, in January, the Mayor of the District of Columbia signed the first prompt pay law to be adopted by a city. The first state prompt pay law of 1985 is the one just signed in Ohio. There will be more this year.

This committee deserves to feel very proud of the role it played in launching this national movement which is doing so much to help small firms.

Small Business Administration. Another organization which has helped us a lot is the SBA. We are not enthusiastic about the proposal for the elimination of SBA. The Chairman of my association Board, Ron Henry, a young, small businessman here in the District of Columbia, has received help in financing through SBA--help we hope will be available to other small firms when they need it. All of us in this room have been helped by the Small Business Advocate, an invaluable resource for getting the small business voice heard within the executive branch.

Taxes. We are equally unenthusiastic about eliminating the special tax brackets for the early net taxable income of small firms. The lower rates for the smallest profits make good sense if we want to encourage small firms to reinvest their capital. Often, for small firms, it is only the profits they make that they can invest--loans are not always available.

Unfair Competition. We thoroughly endorse the testimony before this committee of the Business Coalition for Fair Competition. Having just returned from the annual convention of ICIA, I can report to you that the problem of unfair competition by nonprofits is serious and getting worse. Through tax policy, grant policy and contract procedures, the federal government is helping tax-exempt organizations enter business fields that are being served by small firms. The line between for-profits and not-for-profits is blurred and it may take Congress to re-draw the line clearly. Frankly, we have worked outside of Congress in an effort to find other remedies for the problem. But, so few remedies are available, we may be forced to turn to Congress for help. I am confident that when we do, this committee will be here to listen and assist just as you have on other issues in the past.

Thank you.

STATEMENT OF

WILLIAM J. BIRKHOFER

MANAGING DIRECTOR OF GOVERNMENTAL

AND

INTERNATIONAL SERVICES

REGARDING

SMALL BUSINESS ISSUES

AFFECTING THE ARCHITECT-ENGINEER PROFESSION

BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

February 6, 1985

Washington, D.C.

Mr. Chairman and Members of the Committee, my name is William J. Birkhofer and I am Managing Director of Governmental and International Services at the American Consulting Engineers Council.

As a nationwide federation of over 4,200 independent engineering firms, ACEC represents more than 130,000 professional, technical and support persons. These firms range from sole proprietorships to multi-branch corporations. However, a very large majority are small businesses. Fields of practice include civil, electrical, mechanical, structural and geotechnical engineering, with projects ranging from acoustics to water pollution abatement.

As a representative of so many small firms, ACEC appreciates this Committee's continuing initiatives in establishing a healthy small business environment. Since 36 percent of the services consulting engineers perform over-all are for the federal government, directly or indirectly, ACEC particularly commends your efforts to pass the Competition in Contracting Act (P.L. 48-369), the Defense Procurement Reform Act (P.L. 98-225) and the Small Business Procurement and Competition Enhancement Act (P.L. 98-577).

We believe these major procurement reform measures, by modifying the standards of competitiveness in the federal procurement system, represent a significant challenge to Congress, the

Administration and the small business community to devise new and effective means, within the context of a fully and openly competitive federal procurement system, by which emerging, growth oriented businesses can be helped to become viable and fully competitive through that system, and to ensure that small business in all industry categories receive a fair proportion of available contract opportunities.

With this background, I would like to highlight key areas that ACEC believes this Committee should focus on during this session. A more detailed discussion of each of these points is contained within this statement.

o Small Business Procurement Assistance

The architect-engineer community and other differentially impacted industries, which have experienced excessive set-asides in a period when overall small business utilization, particularly in the Department of Defense continues to decline, question the worth and effectiveness of current policies and programs designed to provide opportunities for today's small business to emerge, grow and become competitive.

To this end, ACEC believes that it is timely and appropriate for the Senate Small Business Committee to review the interplay between size standards development process and set-asides practices within the agencies in the context of the laws governing procurement, technical and financial assistance to small business.

- "Consultant" and "Contractor Support Services" Budget Limitations

  Congressionally-mandated budget cuts for "consultant" or "contractor support services" are being enforced by agencies without adequate or consistent definitions of such service categories. ACEC hopes the Committee will involve itself in helping to define develop a definition of "consultant" and "contractor support services" and to review agency implementation of such budget cuts and their impact on the professions and industries largely dominated by small business is.

- Federal Reliance on Private Sector Firms

  ACEC welcomes the OMB Productivity Improvement Program's inclusion of Architecture and Civil Engineering in the fourteen emphasized categories, but disagrees strongly with the notion of seeking competitive proposals from other federal agencies with "excess capacity." ACEC continues to see the need for a statutory preference for contracting with private firms, to replace the flawed A-76 program, and urges the Committee to consider and endorse such legislation.

- Minority- and Women-Owned Business Programs

  ACEC supports programs designed to increase opportunities for businesses owned and controlled by socially and economically disadvantaged persons. However, we strongly believe that it is important that bona fide socially and economically disadvantaged businesses be capable of competing for procurement contracts, both in the 8(a) program and in the open marketplace.

ACEC encourages this Committee to explore legislation that would require the establishment of criteria for both entry and graduation of firms to and from programs designed to assist developing minority- and women-owned firms which would more satisfactorily ease firms from the preferential small and disadvantaged programs into the small business programs, and ultimately, into the open marketplace.

Small Business Procurement Assistance

In the history of federal efforts to assist small business, the size standard and the procurement set-aside have served as the fundamental tools by which such assistance is provided.

The problems experienced by differentially impacted industries (such as the A/E industry, construction, dredging, and apparel manufacturing industries) suggest that both the SBA size standards development process and the set-asides activities of procuring agencies should be carefully reviewed and evaluated to fully determine their individual and cumulative impacts on these industries.

Significantly, the Small Business Administration, in its December 4, 1984, advance notice of proposed rulemaking for the dredging industry size standard, acknowledged that various compromise approaches might be more acceptable to certain industries than a revision focusing solely on the dollar figure of average receipts over a 3 year period.

The differentially impacted industries have come forth with other alternatives as to appropriate size standards, the administration of agency set-asides, and necessary clarification of the "fair proportion" doctrine. It would be desirable for the committee to conduct an oversight investigation into the experiences of these industries, and to gather input as to possible corrective improvements including use of trade/industry data in size standards development; use of tiered size standards; more accurate delineation of service industry categories under the Standard Industrial Classification (SIC) system; dollar-based on percentage "caps" on set-asides; and certification/graduation procedures.

"Consultants" and "Contractor Support Services": The Need For Definition

The small business firm of today is, as the Committee knows, as likely to provide a service as a product. For many emerging or new small businesses, this service is technical expertise provided by a recognized professional under a scope-specific, close-ended, fixed-price contract. This describes the usual form of contractual arrangement between a consulting engineering firm and its client, whether that client is a governmental unit or a private sector entity.

While there have recently been Congressional and executive budget cuts or restrictions for "consultant services" or "contractor support services", the definition of these services remains substantially undefined. Many agencies such as the Department of Defense tend to disproportionately look to small consulting engineering firms to fulfill Congressionally-mandated small business utilization requirements. We are therefore concerned with development of an accurate standard, and recognizable definition of consultant services.

The lack of such a definition has left agencies to their own resources, and many have turned to the Federal Procurement Data System's Product and Service Codes. Unfortunately, the FPDS Codes provide insufficient guidance on what is, and is not, a consultant, and therefore are inadequate for implementing budget limitations.

The FPDS system serves several important functions of interest to professions, such as consulting engineering, composed primarily of small firms:

1. FPDS data provides a means for continual monitoring of contract award patterns among large and small A/E firms.
2. FPDS data allows monitoring of the degree of competition for A/E contracts from non-A/E firms, universities, research groups and other non-profit entities, and state, local and foreign governments.
3. FPDS data is highly useful as secondary research source on the federal market for A/E services.

Why is the Committee's attention to developing such definitions or criteria crucial at this time?

In the FY 84 Department of Defense Authorization, Sen. Mattingly introduced a ten percent cut in funding for "consulting services." This term was somewhat amplified by Sen. Mattingly's floor comments, but specific definitions were omitted and no standard reference or codes were included.

Public Law 98-473, Continuing Appropriations for FY 85, limited spending for "...consultants, studies, analyses, management support services, or other advisory and assistance efforts...", but failed to define or reference a definition for such activities.

OMB Director David A. Stockman's Bulletin 84-17 (August 8, 1984) targetted $1 billion in savings government-wide in the category of "consultant services," in accordance with the pro-rata reduction targets mandated by Section 2901 of the Deficit Reduction Act of 1984. Unfortunately, the Bulletin's listing of "consultant services" is all-inclusive and highly ambiguous.

Subsequently, the Navy's Headquarters Naval Material Command and Naval Air Systems Command determined that the FY 85 limitations would result in an immediate freeze on further obligations (as of December 11, 1984), and honoring only eighty percent of existing obligations for contractor support services, including the technical engineering services incorrectly included in OMB Bulletin 84-17's limitations.

ACEC has recently been informed that the Navy is drafting a Contractor Support Services policy for use by all the Services, using the Services' regular accounting system to track CSS contracts instead of the FPDS codes.

ACEC respectfully requests that the Committee investigate the definitions used to implement Congressionally-mandated budget cuts for specific services, especially for "consultant" or "contractor support services." ACEC would be happy to assist the Committee staff in developing a more adequate definition for such services.

Federal Reliance on Private Sector Firms

ACEC again urges the Committee to actively explore the favorable impact of "contracting-out" on small businesses of all types, though we recognize that the Committee on Governmental Affairs has primary jurisdiction over this matter.

As this Committe has noted, the federal government has adopted a policy favoring reliance on the private sector, as opposed to in-house government activities, for needed goods and services. Regrettably, however, this policy, embodied in OMB Circular A-76 as currently written, has not been consistently or fully implemented.

Small engineering firms have long been aware of the competition they face from the federal workforce, particularly in the context of competition from the in-house engineering and design staffs of the U.S. Army Corps of Engineers, the National Oceanic and Atmospheric Administration and other federal agencies

For example, in the Corps' civil works activities, approximately 75 percent of all planning and design work is completed in-house.

ACEC has recently participated in a Bureau of Reclamation public/private working group, which has tried to more accurately delineate the commercial activities most appropriately performed by the private sector from those "inherently governmental" functions necessary for proper contract performance and supervision. We look forward to achieving a similar arrangement with the Corps.

Particularly frustrating has been the lack of awareness demonstrated by some agencies of the qualifications, expertise, and competence of small private engineering and research firms. For example, the 98th Congress saw prohibitions or delays on private sector performance of surveying, mapping, and charting services after agency witnesses noted that contractors could be relied upon only for routine or repetitive tasks. This range of services is frequently performed by ACEC firms for state and local governments as well as private sector clients.

OMB Circular A-76 has been inadequate in many respects:

- It is virtually impossible to develop cost comparison standards that fully and fairly equate the operations of a government agency with those of a small business. Agencies under-evaluate or omit many items, and some (such as profit) simply have no equivalent.
- The process by which the comparison is performed is

highly suspect; the government is charged not only with developing the methodology but also with applying it, with no involvement by private-sector interests.

- Current A-76 cost comparison guidelines automatically "handicap" the private sector by requiring at least a ten percent cost differential for "new starts," as measured by an agency-conducted cost comparison.

Circular A-76 is currently being re-examined as part of an OMB Productivity Improvement Program. This program establishes fourteen priority categories for productivity reviews, while exempting from reviews all activities of 10 full-time-equivalent (FTE) employees or fewer. While contracting opportunities will not be restricted to these fourteen categories, they will receive emphasis. ACEC was pleased to find "architecture and civil engineering" as one of the fourteen priority categories.

Critics of the ten FTE provision believe that it severely restricts small businesses' participation in the federal marketplace. To the contrary, the FTE program may prove to reverse the existing losing track-record of A-76 cost comparison studies performed on very small activities providing future opportunities for small firms to engage in more successful agency contracting relationships. ACEC firms anticipate adding to that record of favorable contracting experiences.

However, the Productivity Improvement Program also endorses a concept in conflick with the goal of increased private sector reliance: in addition to seeking proposals from private sector contractors, agencies now "should" obtain proposals from other agencies that have "excess capacity". Such encouragement of second-party proposals provides yet another obstacle to increased federal contracting by small business.

This issue is of particular concern to the consulting engineering profession given that the U.S. Army Corps of Engineers is currently marketing its capabilities to other federal agencies under the theme of "the Corps as the Federal Engineer," and is presently providing or proposing to provide services to the Environmental Protection Agency, and the U.S. Information Agency.

In the 98th Congress, Senator Rudman introduced legislation (S. 1746) to require reliance on private sector suppliers of goods and services. Hearings were conducted in both the Governmental Affairs and Small Business Committees. This legislation, soon to be re-introduced in the 99th Congress, avoids the question of cost which, as described above, has been used to maintain an inflated federal workforce.

While we again recognize that a number of committees share jurisdiction over this issue, we believe that the first casualty of greater in-house performance is small business and we urge the Committee to conduct hearings aimed at passage of legislation providing a statutory mandate for reliance on private sector firms. The appended history of congressional limitations on contracting-out illustrates the need for such legislation.

Minority- and Women Owned Business Programs

Another area of concern to ACEC is SBA's effectiveness in assisting small and disadvantaged firms' development through federal procurement opportunities. It is important that businesses be capable of competing for procurement contracts, both in the 8(a) program and in the open marketplace. By establishing rigorous certification procedures to eliminate all but bona fide socially and economically disadvantaged firms from participation in the preferential programs, SBA would establish a more equitable arena for small and disadvantaged firms to bid on contract proposals. The establishment of criteria for both entry and graduation of firms to and from programs designed to assist developing minority- and women-owned firms could more satisfactorily ease firms from the preferential small and disadvantaged programs into the small business programs, and ultimately, into the open marketplace.

The Veterans Administration has recently begun a program to set aside design contracts on its major construction projects for minority A/E firms under Section 8(a) of the Small Business Act. However, rather than "sole sourcing" contracts to SBA 8(a) certified A/E firms, as is generally the procedure for 8(a) program contracts, the VA awards the contract via traditional architect-engineer selection procedures.

ACEC strongly supports this program because the competition will provide firms with the opportunity to develop business and technical expertise within a sheltered marketplace necessary for eventually successfully competing in an unrestricted environment.

We recommend that the Committee review the current 8(a) program in the context of encouraging other federal agencies to adopt procurement procedures based on competition. In addition, ACEC recommends that the Small Business Act be amended to include women owned and controlled business as socially and economically disadvantaged.

Thank you for providing us with this opportunity to present small business issues of concern to the consulting engineering profession. We lock forward to working with the Committee as it addresses these and other small business issues.

STATEMENT OF JAY MORRIS, MANAGER OF GOVERNMENT RESEARCH AND PUBLICATIONS, NATIONAL RESTAURANT ASSOCIATION BEFORE THE SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 6, 1985

The National Restaurant Association appreciates the opportunity to appear before the Committee to discuss legislative concerns for the 99th Congress. The National Restaurant Association is the leading trade organization for the foodservice industry. The National Restaurant Association's more than 10,000 members represent over 100,000 foodservice outlets nationwide. In addition to restaurants, fast food enterprises and cafeterias, our members provide foodservice for hotels, airlines, hospitals, universities and a variety of other institutions.

Though many people think of the foodservice industry as being dominated by the large, nationally-known chains, the fact is eating and drinking places are predominately small businesses. The vast majority of our establishments have annual gross sales of under $500,000. The average sales, for example, of a full-service restaurant in 1982 were $382,765. In addition, most restaurant owners operate just one unit, and more than half of these units are sole proprietorships or partnerships.

There are a number of general small business issues which the National Restaurant Association has a keen interest and concern.

Among these are the activities of the Small Business Administration, labor issues such as the minimum wage, regulatory and tax reform, capital formation and the impact of the federal deficit on the credit markets. However, my comments will focus on three issues that pose particular problems for the foodservice industry.

The first area concerns the tax simplification plan proposed by the Treasury Department in late November of last year. As we understand it, this plan will be submitted to Congress later this year as part of a comprehensive reform package. Although we are generally supportive of any effort to reform our nation's complex and cumbersome tax code, we find particular exception with one provision contained in the Treasury's proposal. I am speaking of a proposal to limit the deductibility of business entertainment meals, on a per person basis, to $10 for breakfast, $15 for lunch and $25 for dinner, inclusive of tax and tips.

According to a study prepared for us by Chase Econometrics, this "capping" of the busines meal will have a devastating effect on our industry, with a significantly negative ripple effect on the economy as a whole. The impact on table-service restaurants will be extremely detrimental, in many cases causing many fine dining establishments to close their doors.

Chase Econometrics estimates that 140,000 jobs would be lost in the total economy as a result of this cap, or the equivalent of a 0.1 percent rise in the nation's unemployment rate. Chase also found that the proposed cap would result in a $1.1 billion net revenue loss to the federal, state and local treasuries in the first year. The revenue loss would result from job terminations, increased unemployment compensation and welfare payments, and decreases in revenue from income and Social Security taxes. In the second year, the net revenue loss would be even greater, exceeding $1.6 billion.

We realize that this proposal--if it reaches the Congress--will come under the jurisdiction of the Finance Committee, but we hope the members of this Committee, in their role as small business advocates, will take up the cause of the small restaurateur. At a time when reducing the federal deficit is regarded as the primary task before Congress, it seems counterproductive to us to change the tax law in a manner which reduces federal revenues by a significant amount and at the same time seriously disrupts an industry which accounts for five percent of the Gross National Product.

Another issue which we believe may cause undue hardship to small operators is a provision in the Tax Reform Act of 1984. The 1984 Act made changes in the Federal Unemployment Tax Act (FUTA) that amount to an unwarranted tax hike for restaurateurs. Effective January 1, 1986, restaurant operators will be required to pay FUTA taxes not only on cash wages but on all tip income reported by their employees. Under current law, operators pay FUTA taxes on tip income only when tips are used to satisfy minimum wage obligations.

This change poses a significant burden for small restaurateurs, yet it will not translate into a single dollar of increased benefits for unemployed restaurant workers. The fact is federal unemployment tax dollars go toward administrative costs of the unemployment insurance system rather than to benefit payments.

We question the merit of this FUTA increase and favor its repeal before implementation next year. Our industry already pays proportionately more in FUTA taxes than employers in general. And foodservice operators pay more into federal and state unemployment compensation funds than is withdrawn by unemployed foodservice workers.

Finally, our members have expressed reservations about immigration reform legislation that may again receive serious attention in Congress. The Simpson-Mazzoli bill considered in the 98th Congress would have placed a considerable burden on operators, particularly a requirement that employers check at least two employee ID cards and sign a form stating the IDs appear to be valid. We favor a provision similar to the amendment offered by Congressman Thomas Kindness of Ohio in the last Congress which would make this recordkeeping optional. We agree that America's immigration problem should be addressed, but not at the expense of small business people already choked by federal paperwork.

Thank you for this opportunity to express these concerns of the small restaurant operator.

PHCC

National Association of Plumbing-Heating-Cooling Contractors

Pride In Our Past—Faith In Our Future

Statement to the
Committee on Small Business
United States Senate

Presented by:
Sal Farruggia, Legislative Committee Chairman

on behalf of the
National Association of Plumbing-Heating-Cooling Contractors
February 6, 1985

180 S. Washington St., P.O. Box 6808, Falls Church, VA 22046 • 703/237-8100

Mr. Chairman,

Mr. Chairman, my name is Sal Farruggia and I am the owner of two small business contracting companies in Perrineville, New Jersey. One is Garnet Plumbing Company which is a 17 year old company specializing in plumbing contracting. The second is Energy-Wise HVAC, a three year old contracting firm that performs heating and air conditioning work. My companies employ a half dozen people and gross half a million dollars annually.

I am here today as Chairman of the Legislative Committee of the National Association of Plumbing-Heating-Cooling Contractors (NAPHCC). Accompanying me is the NAPHCC Director of Governmental Affairs Dennis Lavallee. In addition to my role in the NAPHCC, I am also Past President of New Jersey State PHCC.

The National Association of Plumbing-Heating-Cooling Contractors is the oldest national association in the construction industry and the largest in the plumbing-heating-cooling industry. It has approximately 6500 members. Membership comes from every state in the country and is organized through about 300 state and local affiliated associations. This industry employs 400,000 people and has receipts of 21 billion dollars.

My appearance here today is also on behalf of the Associated Specialty Contractors. ASC is a coalition of eight national associations of specialty contractors, listed in the Appendix. The segments of the construction industry represented by ASC affiliates consist of about 166,000 business establishments with annual sales of approximately 80 billion dollars and with 1.5 million employees. The large majority of these firms are small business enterprises.

We are here today to highlight our legislative priorities for the 99th Congress and to ask that you include these as you set the Senate Small Business Committee's Agenda and work plan.

UTILITY COMPETITION

The problem of unfair utility competition affects a number of industry sectors which are primarily small businesses. It has become so critical that we have organized the Alliance for Fair Competition, a coalition of 21 national groups who have banded together to combat the unfair and anticompetitive practices by utilities.

What's unfair about utility competition? So why is competition from utilities any different than competition from other businesses?

Small businesses support fair and open competition. However, a utility company is given protected status. The utility is granted monopoly status (free from competition) and is guaranteed the opportunity for a rate of return. In exchange for this protected status, it is regulated by the state regulatory commission.

Usually a large business, its size and resources far outstrips many small businesses in the community. When this protected entity is permitted to compete in other markets, there are market advantages which it enjoys which are unmatched by most others, particularly small businesses.

Picture for a moment a fortress surrounded by fields. Men are competing on the field in hand to hand combat. Symbolizing small businesses, they are limited in resources. The fortress symbolizes the state regulatory commission which provides a protective enclosure for the garrison within. Here the utility can amass its resources and use them -- food, fresh horses, weapons. Then, troops are sent forth to join the field combat. Clearly, they have a competitive advantage that can critically injure, if not destroy, the combatants already there.

What 's the nature of the resources that provides a utility with that market advantage?

1) Cross-subsidization - While generally state regulatory commissions prohibit a utility from using its regulated activities to subsidize its unregulated activities, energy audits are one notable exception in which the utility is congressionally mandated to use ratepayer money to subsidize a business activity currently performed by small business. In addition, we believe that the commissions are not effectively controlling ratepayer subsidization of a utility's indirect costs.
2) Capitalization - The utility may provide loans, loan guarantees, or other financial subsidies to a new business activity.
3) Administration and overhead - Management, planning, accounting, legal assistance, research and development resources may be used by a utility to start up or operate other lines of business. In addition, office space, equipment, or personnel of the utility may be available.
4) Name - Instant name recognition is a valuable asset which a utility enjoys when venturing into a new market.
5) Credit information - From customers' bill payment records, the utility has a built in source of credit information for use in other business activities.
6) Billing - Postage, mailing and personnel costs are already being paid by the rate payers. Adding charges for other business activity to the bill produces very little expense to the other activity.
7) Advertising - In many states, advertising costs can be passed on to rate payers. While advertising directly connected with an unregulated activity may need to be charged to that activity, there are many opportunities for the utility to also include material with advertising promoting its regulated activities. The postage for bill

stuffers promoting a service contract is paid by rate payers as part of their utility bill.

8) Direct mail - With utility bills going out monthly and with immediate access to customers initiating or terminating service, utilities have the most up-to-date mailing lists in existance.
9) Market data - To promote their fuel type, utilities frequently have extensive market data on their customers. This may readily be made available for marketing of its unregulated business activities.
10) Selective referral and market allocation - With its access to information on consumer needs and requests, a utility can make or break a small business by arbitrarily referring or not referring business. That same market advantage can be of tremendous competitive value if the utility funnels the business to itself.
11) Direct from the manufacturer ordering - With larger volume orders, the utility can circumvent usual distribution channels, such as suppliers, contractors, and retailers, and buy direct from manufacturers with possible favorable pricing for bulk orders.
12) Consumer financing - The utility's large capital base gives utility access to providing favorable consumer financing. Financing may be added right on to the utility bill.
13) Consolidated financial statements and tax returns - The utility may reap financial benefits from consolidating its financial data for stock, bond, or tax purposes. Furthermore, rate payers may pay higher utility rates when weak financial statements caused by losses in unregulated activities force up bond prices.

These are some of the more significant benefits which a regulated utility monopoly will have which are not as readily available to unregulated small business. In fact, they may not be available at all. Marketing is similar to politics. Having access to present your story is a major part of the battle.

The Alliance for Fair Competition has extensive files of the many reports which we have received. The Federal Trade Commission is reviewing utility practices and has testified that they are examining about 75 cases in 40 states.

Is this a new problem? In fact, the problem has been around for quite a number of years, but has become of increasing concern in the last few years. Like so many problems, they may subside, but they're soon back to haunt us unless we find permanent and long tern solutions.

Let me give you an historical overview.

A major root of the problem is the competition between fuel types such as when the gas and the electric utilities each strive to maintain and increase their market share. For years, the competition between gas, electricity, and other fuel types has been intensive. Utility companies have relied on promotional practices, supply, installation, service, and financing programs to enhance their position in the market place.

At least once before in recent history, this has produced a public outcry resulting in congressional attention. In 1968, Congressman John Dingell conducted hearings on utility promotional practices before his House Small Business Subcommittee.

In the past, utilities promoted fuel consumption. More recently, the emphasis has shifted to energy conservation. Utility companies have attempted to move into the forefront in an attempt to promote energy conservation. To increase their market share, they strive to make their power source more economical and to lock consumers into their fuel type. This pressure to promote energy conservation while building market share has been increased further by well-intentioned public officials. Energy conservation programs were developed which gave inadequate attention to the effect on competition.

In 1978, Congress passed legislation creating the Residential Conservation Service which requires utilities to offer energy audits. Although the legislation had provisions prohibiting utility supply and installation, numerous loopholes make those prohibitions virtually meaningless.

Meanwhile, the legislation mandates that the rate payers subsidize energy audits provided by utilities which are in competition with those offered by small business. A utility cannot charge more than $15 for an audit which costs a minimum of $100 to $150 to provide.

In 1980, Congress followed up on that by creating the Commercial and Apartment Conservation Service (CACS). This program even further enhances utility involvement by requiring audits of multi-familiy dwellings and small commercial establishments. Furthermore, in its haste to promote energy conservation, Congress made a major oversight regarding competition. Congress failed to include even the weak anticompetitive protections which were included in the RCS program. States are now implementing CACS.

Utilities will be free to offer not only audits to our customres, but also to use the in-home and in-the-business audits as marketing opportunities to promote their own supply, installation, and service programs.

To combat unfair competition problems, the Alliance for Fair Competition was formed. The coalition has been aggressively attacking the problem on several fronts:

1) Small businesses are forming coalitions in their local areas to meet with utilities and to intervene in state regulatory proceedings.
2) When utilities wanted changes in the Public Utility Holding Company ACT (PUHCA), the coalition met with utility representatives to

fashion compromise language that would provide anticompetitive protections.

3) In 1983, the coalition met with Federal Trade Commission staff. As a result of the evidence provided to the Commission, The FTC is now conducting an investigation of utility practices. They reportedly have targeted several cases to pursue.

4) The Senate Small Business Committee conducted hearings on utility competition in November, 1983 which were extremely useful in focusing attention on the problem and possible courses for remedy.

5) Comments were provided to the SBA Office of Advocacy to assist them in producing their March 1984, report on "Utility Competition with Small Business". This report has been extremely valuable in documenting the problem and recommending actions which state regulatory bodies can take.

6) The coalition provided Congress with amendments for the RCS and CACS legislation which would prohibit use of utility programs to compete unfairly with small business.

7) The coalition testified before a House Small Business subcommittee last May during hearings to examine this problem.

Why isn't this a state issue rather than a federal issue?

It is, in fact, a state issue in may states as small businesses initiate and intervene in state commission proceedings. However, unfair utility competition is also an issue for federal public policy concern:

1) When state commissions decline to consider the issue of competition or conclude that they do not have auithority over the unregulated activities;

2) When utility practices violate the antitrust laws;

3 When Congress requires utility activity;

4) When utility activities cross state lines preventing effective regulation by a state commission.

How is the consumer affected? If utilities are permitted to control the market or limit competition, consumer choice is reduced. Yet the consumer has been required by the state regulatory commission to subsidize the indirect costs of the utility to conduct its unregulated activities which are now reducing consumer choice.

The consumer would be better served if the unregulated activities of a utility are expensed at full market based costs and credited to the utility function. If a bill stuffer goes with the utility bill, all of the costs for the bill stuffer, postage, and mailing would be charged to the unregulated activity. Such a proposal would lower rates since many of the indirect costs would no longer be charged to the rate payer, but to the unregulated activity.

PROCUREMENT

There are several changes that should be made in procurement of construction. While progress has been made on some policies, they stop short of providing the full measure of equal treatment that they should provide, particularly for subcontractors and particularly for jobs funded by the federal government through grants, loans, or other assistance.

1. Elimination of Retainage

Retainage is a practice used in construction to insure completion of a contract. Under this practice, part of the payment for completed work, frequently 10% is withheld from the contractor until the total contract has been completed.

When the practice of retainage first began, government agencies usually dealt with a single general contractor who performed most of the work with his own employees. Agencies withheld a portion of each progress payment as leverage to ensure the work would be completed satisfactorily. Naturally, contractors included the cost of this loss of use of their money in their prices.

Today, more than half the work is subcontracted. Retainage withheld from the prime contractor is withheld by him from the subcontractor and by the sub from lower tier contractors.

In a survey which we took of our members in 1982, we found that contractors increase their bids to cover this cost. The median increase was 3% of the contract price, but more than a quarter of the people responding reported increased prices ranging from 5% to 15%. We believe such increases are also added in by prime contractors and lower tier contractors.

The problem with this practice is that the protections it provides are duplicated by the far less costly practice of performance bonds.

Most government and construction contracts are protected by a performance bond with a surety company and paid for by the contractor to insure completion. Although this too is included in the contract price, our survey reported that the median increase in bid was only 1 1/4%. This is far less than the cost of retainage.

However, the government does both, the government and the tax payer are paying for an unnecessary layer of protection. While the government could be covered by 1 1/4% of the contract price for the performance bond, it's paying 240% and more of that amount for duplicate protection by withholding retainage.

Fortunately, the wisdom of the Senate saw the inequities in that. Through the leadership of Senator Weicker's sponsorship and the cosponsorship of other members of the Senate, the Senate passed legislation in 1982 that would eliminate retainage. Unfortunately, that legislation did not clear the House before adjournment.

However, as a result of that legislation, the Office of Federal Procurement Policy reviewed the government's policy on retainage. Policy letter 83-1 states that retainage should not be routinely withheld on direct federal construction. However, there are no requirements that retainage be released to subcontractors and retainage continues to be withheld on federally assisted work.

Thus, we ask that you again take up this issue and pass legislation eliminating retainage on federal or federally assisted construction, and providing that the release "flow-down" to subcontractors.

- Elimination loosens up cash flow and stimulates the economy. Retainage places severe restraints on a contractor's cash flow, requiring contractors to borrow at current high interest rates.
- Elimination of retainage would free up funds for operating capital for expansion, seeking new contract opportunities, and producing new jobs.
- Elimination speeds up project completion. Retainage slows down completion of a job. When funds are withheld from a general contractor until a project is completed, he withholds from subcontractors. Particularly those subcontractors at the early stage of construction have less incentive to complete the total work since they have to wait months or years to receive retained funds.
- Elimination lowers construction costs. Since contractors must frequently borrow to cover outstanding retainages, this cost of

borrowing is passed on to the construction purchaser, the tax payer.

- Retainage is not needed on bonded jobs. Contractors are required to post payment and performance bonds to guarantee that work is completed. Therefore, retainage is an unnecessary duplicate protection of the government's interests.
- Elimination stimulates competition. Because of restricted cash flow and frequent slow payment of retainage, contractors avoid public construction. Eliminating this barrier will stimulate their reentry into the market and produce lower costs through competitive bids.

Retainage should be eliminated and bonding should be used as the single, best source of protection.

2. Prompt payment of progress payments

When the Prompt Payment Act was passed, the construction industry concluded from the language and legislative history that the requirement that the government pay its bills on time or pay interest would apply to construction work. Construction projects frequently require contracts that extend over many months under which progress payments are made for construction work completed.

Until recently, in narrow interpretations of the Act, federal agencies had determined that progress payments were for financing purposes rather than for work completed. In so doing, they had excluded the construction industry from coverage by the Prompt Payment Act because the act does not cover payments for financing purposes. A recent OMB change makes partial payments for work completed eligible under the Prompt Payment Act, thus qualifing construction payments.

However, contracts financed with federal funds, such as grants and loans still produce late payments to small businesses. Frequently, we have been receiving reports of late payment of progress payments by construction industry contractors. This problem is further complicated because payment must first be made to the prime contractor who then uses the proceeds to pay subcontractors, and they in turn their second tier subcontractors, etc. It is not unusual for some subcontractors to receive payments months after work has been completed.

The Prompt Payment Act was intended to assist small businesses in getting timely payment from the government so that they could maintain themselves as viable economic entities with the ability to compete in the marketplace.

The complete beneficial effect cannot be felt until the same principles for fair treatment are extended to projects supported by the federal government.

3. Contracting out

We also support the contracting out of work which can be provided more efficiently and economically by the private sector than by the government. Except for areas of safety, national security and similar such selected purposes, the private sector should be given the full opportunity to demonstrate that it can provide the goods and services as economically as the government can do by itself.

We have no objection to competing against fair government estimates of its cost for doing the work, provided that the government has included all of its costs, including overhead, use of equipment, etc.

We would urge that the government break out contracts to provide opportunities to small businesses. Rather than umbrella contracts covering a broad range of activities, separate contracts should be negotiated with small businesses for identifiable sections of work. Particularly, in construction we would urge the greater use of separate contracts which has produced consistent savings in states, such as New Jersey, of as much as 10%.

4. Bid errors and adjustments

The U.S. General Accounting Office (GAO) has ruled regularly in favor of a public policy on federal and federally-assisted, competitively-bid contracts which allows a low bidder who can demonstrate an error in his bid to upwardly adjust his bid price to the extent of the error. He will be awarded the contract at the adjusted price so long as the price, as adjusted, is still below that of the second low bidder. According to the GAO, protests over such situations are a common occurrence, and rulings are regularly issued in favor of the low bidder who adjusted his price.

Contractors abhor this practice and recommend a change in public policy. Allowing a low bidder to adjust his price under any conditions, other than change orders issued after the contract is underway, undermines the entire system of competitive bidding and is an open invitation to fraud and deception.

We strongly recommend and urge adoption as public policy on federal and federally-assisted construction the following procedure:

> When an apparent low bidder on a federal or federally-assisted construction project discovers an error in his bid which would lead to an increase in his bid price, he shall have the following options:
>
> 1. He may, at his option, perform under the contract at his original bid price, or
> 2. He may withdraw his bid, without penalty or forfeiture of bid security, if he establishes that a valid computational or transcribing error resulted in an unintentionally low bid, but shall not be allowed to re-bid the job under any circumstances.

The awarding agency shall then have the option of awarding the contract to the second low bidder or of resoliciting bids for the project. In the event the project is re-bid, the former low bidder shall not be allowed to bid for the contract.

Under no circumstance shall an adjustment in bid price be allowed a bidder as a result of an error in his bid. The Associated Specialty Contractors, Associated General Contractors and the American Subcontractors Association have jointly adopted this policy statement.

5. Office of Federal Procurement Policy

With proposals to restructure government and eliminate agencies, we want to provide our support to the Office of Federal Procurement Policy (OFPP). As part of the Office of Management and Budget (OMB), it is properly placed under the Executive Office of the President. In its centralized location, it has ably served as a focal point for procurement policy.

OFPP has demonstrated the value of centralizing policy over the procurement process. It provides uniformity which saves taxpayers money and leads toward a single more unified and simplified system which small business can understand.

TAXATION

1. Mixed Use Vehicles

Last year, Congress passed the Tax Reform Act of 1984. Among other revisions, it significantly changes provisions affecting the ownership and deductibility of business vehicles and equipment. Internal Revenue service regulations are further increasing the tax and paperwork burden on small business, particularly where so-called personal use occurs.

The new rules broadly define "personal" use. Use of a car, van or truck to commute will be "personal" use even if use of the vehicle is for the convenience and benefit of the employer.

Construction contractors maintain a fleet of cars, vans, and trucks to make service calls and to provide an onsite storehouse for tools, parts, and equipment for use at the work sites. It is frequent and usual practice to require employees to take a vehicle home for any one or more of the following reasons:

a. Security

b. Lack of storage space at the shop

c. Availability for emergency service calls.

In new construction, it is difficult to maintain security on the job site after work hours. Building materials are stolen and vehicles are broken into. When employees take these vehicles home they drive them into their own residential neighborhoods which provide better security.

If employees stop taking vehicles home, the cost to the contractor for security increases. Either additional security measures must be taken at the job site, or some other secured parking facilities in the area must be found. The first option increases insurance costs and the second increases storage costs. If the vehicles are returned to the shop each day, there is the additional travel time and cost to and from the job site each day. If the employee does not take the vehicle home, but rather drives first to the storage place of the vehicle, the contractor looses the productive time while the employee picks up the vehicle and takes it to the job site.

Because contractors maintain a fleet of vehicles, they do not always have the space at their shop or place of business to store them. If all the vehicles are returned to the shop then the contractor faces increased expense, either to buy or rent space for vehicle storage.

Contractors also require employees to take their vehicles home to have them more readily available for emergency service calls. If a consumer calls in the middle of the night that the furnace has gone out, an employee can be called and dispatch readily to make the repairs, since tools and equipment are readily available.

Let us track that same emergency service call, if the service truck is left at the shop. The consumer calls to report "no heat". The contractor telephones an employee to make the emergency service call. The contractor must go to the shop or to storage area so that he can unlock the yard where vehicles are stored. Meanwhile, the employee must travel to the shop, pick up the vehicle, and then travel to the consumers to service the "no heat" call. When the furnace is repaired, he returns to the shop to return the vehicle. Meanwhile, the contractor either waits at the shop for the return of the vehicle or goes home to return later to again secure the service vehicle. Then the employee returns home.

Since emergency calls are usually billed from the time of the first call to the employee to his return home, there is both a significant increase in inconvenience to the contractor and an increased cost to the consumer. There is also the negative public relations which the contractor experiences by a consumer who believes the contractor is taking advantage of the emergency.

If employees continue to take vehicles home,that "personal" use will be taxable to the employee. Some employees have already indicated that they will not take vehicles home under those conditions. Employees who do would be subject to taxation and withholding on the value of the so called "personal" use.

The rules require a contemporaneous log or diary be kept on each use of the vehicle where any personal use is involved. For a vehicle that goes from job site to job site or is used by several different employees during the day, that is an extremely burdensome and time consuming chore. It takes away from the productive time which should be spent on the job. Failure to keep the contemporaneous record persumes that total usage is personal, which increases the employee's tax burden and eliminates the company's legitimate tax benefits.

The rules also reduce the tax credits and depreciation which can be taken for vehicles. The investment tax credit and depreciation must be reduced proportional to the percentage which a vehicle is used for "personal" use. The use of each vehicle will vary and each will require separate calculations of the proportions of business and "personal" uses.

These tax credits and depreciation schedules were put in place to encourage investment in business expansion. Reducing their use discourages that purpose.

Recently, the Internal Revenue Service announced that it is issuing new rules with standard formula to be used for allocating business and personal uses in lieu of the record keeping. For the construction industry, these are of little value.

While certainly it would relieve contractors and their employees from onerous record keeping, it does not solve the basic problem. The basic problem is that vehicles used for commuting are serving legitimate business purposes of the small businessman in his effort to hold down business expense and maintain productivity.

We believe that the changes in the law which require record keeping and increased taxation are outrageous and Congress should repeal them immediately.

2. Taxation of fringe benefits.

As the federal government seeks to increase revenue, there is increased attention at attempting to tax fringe benefits. Fringe benefits are non monetary forms of compensation to compete for and attract good employees and to help maintain their health and well-being as an asset for the company. To tax any value of this nonmonetary compensation will require employees to use their monetary income to pay the tax. This reduces their disposable income which would otherwise be available for basic needs. It may in fact, lower the standard of living.

We do not believe that the Congress should be attempting to tax fringe benefits. If such changes are made, it will increase the cost to small businesses both to remain competitive and to compensate employees for their lost monetary compensation.

SMALL BUSINESS ADMINISTRATION

The current budget proposals call for the elimination of the Small Business Administration. That recommendation is bad public policy. The SBA, and particularly the Chief Counsel for Advocacy, have been extremely valuable assets to stimulating and improving small business and the economy.

The Office of Advocacy is able to analyze the impact of government policy on small business and to play a meaningful role in assisting small business constituencies.

If the administration believes that a change in the structure of the small business administration is needed, we believe a more constructive approach would be to make the Office of Advocacy an independent agency. This would provide a greater flexibility for the Chief Counsel to examine and intervene in a broader array of government activities on behalf of small business.

Other SBA programs are not directed toward the service or construction sectors. Thus, our membership do not use those SBA programs. However, it is our impression that the management of these programs could be upgraded and these programs tightened up.

EQUAL ACCESS TO JUSTICE ACT

Initial Passage of the Equal Access to Justice Act provided a valuable tool for small business to guard against unwarranted government action. It served as a check on agencies who might otherwise pursue small businesses without basis or with novel theories of enforcement. In addition to serving as a check on agencies, it has also provided the mechanism for small businesses to challenge decisions which adversely affect small business.

We were pleased when the last Congress approved the legislation to reauthorize the Equal Access to Justice Act. We were disappointed when the President voted it. We would urge the Congress to move quickly to reauthorize the legislation to insure that the momentum which has began will continue.

CONCLUSION

As you identify the committee's plans, we urge you to incorporate these small business issues.

Utility competition - The committee should continue its oversight function. This includes obtaining the Congressional Research Service review of state authority over unregulated utility activities and consideration of further hearings or legislation on the lack of meaningful authority.

Procurement - We urge consideration of legislation to extend elimination of the routine use of retainage and prompt payment. These should include federally assisted work and require that these be basic tenets of subcontracts. We urge greater reliance on contracting out and a change in policy on bid errors and adjustments. We support the Office of Federal Procurement Policy and urge that it be maintained as a centralized facility for coordinated procurement policy.

Taxation - We urge that tax law which requires unwieldy contemporaneous recordkeeping and which defines use of vehicles that benefit the employer as "personal" expense be repealed. Taxation of fringe benefits likewise will adversely affect small business employers.

Small Business Adminstration - We support retention of SBA, particularly the Office of Advocacy. Consideration should be given to making the office an independent agency. Administration of other SBA programs should be examined and improved.

Equal Access to Justice - We urge that the legislation be reauthorized.

Thank you for this opportunity to appear. We would be happy to answer any questions.

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APPENDIX

MEMBERS OF THE ASSOCIATED SPECIALTY CONTRACTORS

Mason Contractors of America

Mechanical Contractors Association of America

National Association of Plumbing-Heating-Cooling Contractors

National Electrical Contractors Association

National Insulation Contractors Association

National Roofing Contractors Association

Painting and Decorating Contractors of America

Sheet Metal and Air Conditioning Contractors National Association

TESTIMONY OF

VIRGINIA LITTLEJOHN
EXECUTIVE DIRECTOR
PROFESSIONAL SERVICES COUNCIL

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 6, 1985

Mr. Chairman and members of the Committee:

I am pleased to have this opportunity to appear before the Senate Small Business Committee to discuss small business issues in 1985, particularly as they affect small professional and technical services firms. Because of the emergence of small "thoughtware" companies as a dynamic force in the growth of our economy, it is important that policymakers understand how these new capabilities are changing the economy, and the needs of those small firms that are creating most of the new jobs in the United States.

I appear in my capacity as Executive Director of the Professional Services Council whose members are firms and associations which are an integral part of the emerging services sector. They are providing professional and technical services that are on the leading edge of technological change. These high services firms using high technology are research and development centers, independent laboratories and test facilities, architect and engineering firms, systems integration and support activities, program analysis and evaluation companies, computer software development and engineering houses, to name a few. Their personnel include engineers, mathematicians, chemists, physicists, statisticians, computer scientists and programmers, artificial intelligence specialists, lawyers, accountants, program analysists, operations research experts, and specialists from numerous other disciplines.

The thoughtware economy. Over the last decade, the American economy has experienced a great deal of turbulence. Thanks to the work of David Birch at MIT we are learning about the nature of this turbulence. Each year we lose eight to ten percent of our corporations and jobs. Places that were growing rapidly in the 1970s have suddenly stopped growing. Other localities that were suffering in the 70s, such as New England, are booming. This turbulence is a consequence of the change we are experiencing, but that turbulence offers many golden opportunities. Commentators have described the change as a shift from a manufacturing economy to a services economy. It is estimated that since 1968 we have created 2.6 million jobs in the American economy, expanding our employment base by 39%, without adding a single manufacturing job. Presently only 21% of our non-agricultural work force is employed in manufacturing companies and approximately half of these workers (about 10%) is actually manufacturing anything. Another 2.5% of our work force is engaged in agriculture and the remaining 87.5% do something else. A deeper analysis of these numbers shows that the shift is not only from manufacturing to services but from physical activity to the use of our brains. The real growth of the economy is coming from companies and sectors that are capable not only of innovation, but in the application of these innovative ideas and techniques.

Where in the past the economy was characterized by the manufacture of products which had long "half lives" (that is, a long period before the product became obsolete), now we have moved to an economy based on very short half lives (such as computer software).

When we talk about economic sectors that are characterized by high levels of innovation, we include small and medium sized companies in the manufacturing sector (such as steel and textiles) which are rapidly and efficiently applying innovation to their industrial processes and companies that have no hardware products, but rather produce what I have called thoughtware. This includes computer software, finance, health, telecommunications, engineering services, education, training and the like. Innovation in the manufacturing sector is serving to produce goods more productively and economically, but regretably at a cost in the loss of jobs. Innovation in the thoughtware sector is creating new jobs at a rapid rate.

The changes in the mix of what we do for a living is having a significant impact upon the structure of the corporate world. The character of the thoughtware sector offers increased opportunities for innovation and entrepreneurship. Since capital needs in starting an innovative small service firm are not as great as are required to start a capital intensive manufacturing operation, barriers to entry in the marketplace are lower. An indication of what this means is the sharp increase in the number of new companies. In 1950 there were about 90,000 new incorporations. By 1975 it had increased to 300,000. In the last couple of years over 600,000 new business have been created each year. This does not even include roughly 400,000 partnerships and 300,000 self-employed individuals.

What is striking also about the emergence of this new services and information economy is that attention is shifting from cost to quality. Employers are seeking out more highly educated and trained labor forces, improved delivery of services, a better quality of life, and greater research and development support. This change makes good sense. If growth of the economy is dependent on innovation and innovation is a function of creative, well-educated people, it stands to reason that we are dealing with a whole new ball game. Unfortunately it is our strong impression that federal policy is lagging far behind the needs of this new economy and in some specific ways is posing barriers to its health and growth. Let me try to illustrate.

Statistical information and data. The present federal data collection systems do not begin to reflect the central importance of innovative services firms in production, employment and trade. The existing collection systems neither provide the data needed by government policymakers to develop sound economic, tax, trade and administrative policies; nor do they provide the essential information which the private sector needs to better understand the marketplace and its composition and to prepare business forecasts and projections.

More specifically since the Standard Industrial Classification Code (SIC) provides a methodological framework that is used by the principal economic and statistical data gathering systems of the federal government, it should accurately reflect the structure of the American economy. That the present SIC code seriously under-represents the services sector can be seen from the fact that the goods producing sector is represented by 599 different industries, although they provide only 27% of employment and 33% of the gross national product. The services sector with more than 70% of the jobs and over two-thirds of the gross national product has only 423 industries identified in the SIC. A comprehensive and fundamental overhaul of the present classification scheme is badly needed. Representatives of the professional and technical services sector have submitted a new classification proposal to the Office of Management and Budget in response to its notice of an intent to revise the Standard Industrial Classification manual. We are concerned, however, at the length of time that will be required to complete this undertaking and the commitment of the Executive Branch to make the kind of basic changes that will properly compile data on the economy as it is and is becoming.

Procurement reform. Federal procurement is one of the most important ways that national policy affects the services economy. The government meets its needs directly through the use of government employees, indirectly through non-profit organizations or by the acquisition of services by contracting with the taxpaying private sector. Those of us in the private sector familiar with the procurement process consider it to be seriously flawed and an example of federal regulation at its worst. The procurement laws, rules and policies, as presently framed and implemented, produce major inefficiencies and dislocations. There are some pending problems and opportunities which I would like to describe.

1. Improved methods to procure professional and technical services. As part of the Competition in Contracting Act of 1984 (P.L. 98-369), a requirement was included that the Office of Federal Procurement Policy recommend to Congress a plan to increase the use of "full and open competition in the procurement of professional, technical and managerial services . . . [which] often involves the use of evaluation criteria (such as qualifications and quality), other than price in the selection of

the winning vendor." We cannot stress too strongly the need in the emerging economy for government to develop a process which selects providers of "thoughtware" on the basis of qualifications and the ability to provide a quality product, rather than primarily price, and to give legitimacy and credibility to achieving "full and open competition" in procurement by properly taking into account professional and technical factors as well as cost. We hope that this Committee will take a direct interest in the recommendations of the Office of Federal Procurement Policy and seek the comments of informed parties on procedures which assure that the government is procuring innovative professional and technical services on the basis of quality not just cost.

2. The rule of two. While the OFPP study of an alternative methodology for procuring professional and technical services holds hope for basic improvement in the system, the rule of two requirement contained in part 19 of the Federal Acquisition Regulation holds the potential for arbitrarily eliminating from the federal market highly qualified small and growing companies of the very kind that characterize quality and the cutting edge of innovation. On the one hand, through the leadership of this Committee and Congress, a highly constructive initiative was taken by passage of the Small Business Innovation Research Act. "Small" for purposes of the Act was defined as firms with

500 employees or less. By way of contrast, the small business size definition standards for other innovative professional and technical services firms is set at $3.5 million in gross revenues. By implementing a rule which would ultimately set aside virtually all procurements in the professional and technical services sector, the rule of two would be a powerful barrier to encouraging highly entrepreneurial firms which are growing, creating employment and leading the charge for innovative change in our economy from entering and serving the federal market. The rule of two does recognize where R&D small business set asides are involved that there must be "a reasonable expectation of obtaining from small business the best scientific and technological sources consistent with the demands of the proposed acquisition for the best mix of cost, performance and schedules." What must be recognized is that R&D is only a small part of the range of highly skilled services the procurement of which should be based upon the best or highest quality contractor performance. Frequently these will not be firms which technically qualify as small businesses under the size standards currently in effect, but which in market terms are small in comparison with the Fortune 1000.

3. The captive nonprofit (Federally Funded Research and Development Centers).

Ironically the increasingly complex and arbitrary character of the procurement process is forcing more and more work in the field of technical and professional services to be contracted to nonprofits which are captive to the federal government. Currently, they receive almost $5 billion of professional and technical services work on a sole source basis each year. This trend circumvents competitive procedures for the procurement of professional and technical services and directly hurts small growing businesses which should be encouraged to do business with the federal government. In recent months, as examples, the Department of Defense has announced the establishment of two Federally Funded Research and Development Centers -- the Software Engineering Institute and the Logistics Management Institute. Other FFRDCs are under consideration. FFRDCs established after World War II before there was a dynamic growing private professional services sector are growing in size and scope when they should be less and less of a factor in the federal market.

We think that it is essential that the Committee hold oversight hearings to understand how recent procurement initiatives, designed to help small business, may unintentionally be having exactly the opposite effect. The size, scope and nature of the work of FFRDCs on behalf of the Defense Department and other federal agencies requires the urgent attention of this Committee and specific recommendations need to be made to assure that nonprofits captive to the federal government are limited to only those missions that cannot otherwise be undertaken by highly capable private sector organizations.

4. Limitation on "advisory and assistance services". One of the most damaging developments in recent years has been the government's efforts to limit the federal use of highly innovative small firms in the "thoughtware" business. By using a crude label, "beltway bandits", for the very kind of firms that represent some of the most capable sources of innovation in the country, Congress and the Executive Branch have been mistakenly trying to impose new restrictions and limitations on federal access to such quality services. Let me provide two current illustrations.

a. Proposed Executive Order regulating use of "advisory and assistance services". The Administration has under active consideration a proposed Executive Order which would limit federal use of "advisory and assistance services". The definition of these services includes large segments of the small business services sector which represent the driving force of the present economy. This initiative, coupled with a number of other specific barriers to working in the federal market, is having the effect of reducing government's ability to work with sources of talent wherever they may be in the private sector -- and increasingly that means small emerging firms.

b. Limitation on expenditures for Contractor Support Services by the Defense Department. Section 308 of the Fiscal Year 1985 Authorization Act for the Department of Defense establishes a $1.3 billion limitation on expenditures for "consultants, studies and analyses, management support, contract systems engineering and technical engineering services". A complex problem of defining the scope of this restriction and implementing it in a rational way has been raised. The Defense Department has responded by essentially freezing expenditures for outside services contractors for the Department of the Navy and similar draconian reductions are anticipated shortly in other areas of defense. Predominantly technically oriented small businesses are being forced to terminate personnel and deal with extremely difficult cash flow problems.

Surely no one can argue that the economy's rapid transition to new forms of economic activity is challenging. Never before have entrepreneurship and innovation flourished as they are in thousands of different ways in America today. Increasingly we have a growing array of facts at our command

and the technology to make sense out of them. Now what is needed is the human resources to take advantage of these major breakthroughs. Unfortunately federal policy toward these small emerging service companies which represent these new human resources more often than not is hostile and unresponsive. We believe that this Committee can play a central role in creating understanding for the new emerging small business information and services economy and fashioning constructive policies to take advantage of its unique capabilities.

Thank you.

TESTIMONY OF
NEIL GRAY, DIRECTOR OF GOVERNMENT RELATIONS
OF THE NATIONAL ASPHALT PAVEMENT ASSOCIATION
TO THE SENATE COMMITTEE ON SMALL BUSINESS
FEBRUARY 6, 1985

Ladies and Gentlemen, my name is Neil Gray and I am the Director of Government Relations for the National Asphalt Pavement Association (NAPA), based in Riverdale, Maryland. NAPA's membership is comprised of the producers of hot mix asphalt and the contractors that use asphalt in the construction and maintenance of all classes of highways, airport runways, parking facilities and various other applications. Approximately 85% of NAPA's membership qualify as small businesses under the definitions established by the Small Business Administration.

I have just returned from NAPA's 30th Annual Convention where I had the opportunity to ask our membership firsthand about their primary concerns as private businessmen and small businesses, the following represents a summary of what was related to me and which I hope the committee may find useful;

Interstate Cost Estimate

One of the greatest concerns of the asphalt industry, as well as the highway construction industry in general, is the continuing inability of the Congress to approve the Interstate Cost Estimate (ICE). While this problem does not fall directly under the purview of the Small Business Committee, the gravity of the situation, and the effect it has had, and will continue to have in future, should, I feel, be brought to the Committee's attention.

The Interstate Cost Estimate is a technical document submitted periodically to the Congress by the Federal Highway Administration (FHWA), which contains the estimated cost to complete the System of Interstate Highways for Defense and Mobility. Congressional approval of this estimate is required before the FHWA can dispense funds from the Highway Trust Fund, which is financed through the collection of the Federal taxes on gasoline and diesel fuel.

Interstate Cost Estimate - cont'd

For a variety of reasons, the Congress has been unable to come to an agreement on approving the ICE since 1983, which has resulted in the with-holding of more than $7 billion on funds dedicated to completing and maintaining the Interstate Highway System. This delay has kept the Federal Highway program at a funding level comparable to that which existed prior to the 5¢ per gallon fuel tax increase mandated by the Congress in 1982, despite the fact that the actual monies available have increased dramatically.

Without a stable source of Federal funding for the highways, many states found last year that to ensure the integrity of their highways, and to keep the highway construction industry from collapsing in their states, they had to advance their own state monies for highway projects with the hope that the Federal funds would soon be forthcoming. The Federal funds have yet to be released, and many of the states have been burned by the experience. It is unlikely that many states will be willing to advance funds for highway projects without very strong evidence that the monies would be repaid. As a result, the State level Departments of Transportation are being very tentative in their construction schedules, reducing significantly both the size and number of projects that will be available for bidding by the highway contractors.

The crux of the problem is; until the Congress approves the ICE, tax monies already collected from the highway users cannot be released to the states, which in turn, cannot plan their construction and schedules nor put the projects out to bid by the highway contractors. When the total sum being withheld due to Congressional inaction is divided among the potential number of companies available to utilize the highway funds, the sum of $3 million dollars per firm, not including the attendant multiplier effects on employment and related spending are being lost. The Secretary of Transportation, in a recent letter to the Congress put the lost work alone at a level of 200,000 person years of employment.

I relate this problem to the Committee only in the hope that the widest possible exposure of the problem and it's ramifications may lead to a solution for a problem which has concerned our industry for almost two years. A factual summary of the problem is attached (Appendix A).

Preferential Set Asides in Federal Contracting

It has always been NAPA's policy to assist our membership in complying with the Congressionaly mandated requirements giving preferential treatment to Disadvantaged Business Enterprises (DBE's), despite the philisophical opposition of our members to any measures which artificially restrict the operations of the open, competitive market.

Preferential Set Asides - cont'd

The primary complaint concerning DBE's involves the onus placed on the contractor, in locating and certifying a DBE to perform the required portion of a contract. The additional paperwork and the need for the contractor to assume liability for the performance of the subcontractor creates a disincentive for bidding on Federal projects, further reducing competition in the open market. It is widely felt that the responsibility for such programs intended to establish social equity should fall to the State or Federal agencies, which are better able to determine the viability of prospective DBE's and that these agencies should also bear the liability for such determinations, rather than the private contractor, whose primary interest is in acquiring and performing business projects.

A further problem arises for those businesses which are active in the secondary aspects of highway construction such as landscaping, painting or erosion control. Many companies that have been active in these fields of work for years are finding themselves locked out of many prospective jobs since these same activities lend themselves to meeting the DBE goals in a major project. This realm of contracting is marked by relatively low starting costs and is subject to some of the fiercest competition in highway contracting. In attempting to meet the goals required by Federal agencies, many prime contractors have little or no option but to subcontract these portions of a project to a DBE, irregardless of whether or not this might be the most cost effective or efficient utilization of available services.

Taxation

The asphalt pavement industry is comprised of privately owned and operated companies that must observe common business practices such as limiting expenditures to available income, repayment of debts and basic financial prudence in order to stay in business.

There is a strong feeling that the Federal Government can and should be operated under a similar premise, in order to minimize waste and to achieve a greater level of efficiency. The continuing Federal deficits as well as the massive gross Federal debt have major effects on the operation of private industry, as an example, the increasing Governmental presence in the credit markets, required to cover the interest payments due on the Federal debt, raises interests rates and effectively closes out much of the private access to these same markets.

NAPA favors any practical attempts to rationalize the financial status of the Federal Government and has recently offered testimony in the Senate suggesting a means of dealing with this problem. As this proposal was quite extensive I have not included a copy with this testimony but would be glad to furnish the committee with copies if desired.

Reduction of Paperwork

The heavy load of paperwork required by the Federal Government is one of the most frequently heard complaints associated with Federal contract work, and these loads are regularly increasing. These demands for documentation and reporting significantly reduce the amount of productive employee time available to an employer and creates an artificially imposed layer of bureaucracy in the company's operations.

Any efforts to reduce the levels of required paperwork would assist in boosting a company's productive output and would allow greater utilization of employee efforts. Increased productivity would benefit not only the company but the nation as a whole.

The National Asphalt Pavement Association has traditionally placed the best interests of America before the interests of the asphalt paving industry, and the industry's interests before those of the Association. We believe that a strong and healthy America fosters the very best environment for our own business welfare.

We appreciate the interest of the Senate Committee on Small Business in the concerns of our industry and the NAPA staff and members stand willing to assist the Committee in any way we can.

(APPENDIX A)

The Interstate Cost Estimate

Definition of ICE

The Interstate Cost Estimate (ICE) is a technical document submitted by the Federal Highway Administration (FHWA) to the Congress, containing the estimated cost to complete the Interstate Highway System. New estimates are required periodically to reflect the completion of previously approved projects. Due to a ruling of the Supreme Court in 1983, the ICE must be introduced as a formal bill before the Congress, and must be approved by the Congress before the Interstate funds can be released. The release of 85% minimum apportionment funds (states are guaranteed a return of at least 85% of the funds they contribute to the Highway Trust Fund) are tied to the ICE since the minimum cannot be determined until all funds for a given year are authorized for use by the states.

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Legislative History - the ICE was first mandated by the Federal Aid Highway Act of 1956, which created the Interstate Highway System for Defense and Mobility. The following table shows the date that the FHWA submitted the ICE for Congressional approval and the period that the approval was granted for.

Submitted	Period of Approval
January 1958	1960 to 1962
January 1961	1963 to 1966
January 1965	1967 to 1969
January 1968	1970 to 1971
April 1970	1972 to 1973
January 1972	1974 to 1976
July 1975	1977 to 1978
March 1977	1979 to 1980
August 1979	1981 to 1982
January 1981	1983 to 1984
March 1983	1985

June 23, 1983 - the Supreme Court struck down the "legislative veto", which had allowed the Congress to approve measures that weren't formal bills. This action overturned previous Congressional decisions including the 1983, 1984 and 1985 ICE's.

March 1984 - Congress votes to approve a partial ICE, releasing 1/2 of the funds earmarked for use in 1984.

January 1985 - FHWA submits a new ICE to Congress to approve funding in 1985 and 1986 and release the 1984 and 1985 funds that have not been released.

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National Asphalt Pavement Association

Summary of Legislative Actions

1983 - After the Supreme Court ruling on the legislative veto, numerous bills were introduced in the Congress to approve the ICE, but these bills called for major increases in spending to pay for many local interest demonstration projects, despite the FHWA's frequent requests that no additional spending be included in the ICE.

The House and the Senate were unable to resolve the major differences between their major ICE bills and the Congress adjourned without an approval.

1984 - The Congress continued to debate the merit of interest projects, but in response to public protests approved a stop-gap 6 month ICE, releasing 1/2 of the monies available for the interstates in 1984.

Continued demands for demonstration projects, a reconsideration of the 85% minimum allocation formula and major mass transit programs caused enough conflict in and between the Houses of Congress to deadlock any further action on the ICE in 1984.

1985 - The Senate has introduced two measures to approve the ICE quickly, but a full Senate vote is unlikely before April 1st.

The House of Representatives has yet to introduce any measures, but is expected to release a bill during the second week of February. This measure is reported to contain significant demands for demonstration project funding as well as higher funding for mass transit projects.

The Secretary of Transportation is strongly urging the President to veto any Congressional measure calling for increased spending, and is pushing hard for a "clean" ICE and the transfer of future approval authority to the FHWA.

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Major Points of Conflict

Demonstration Projects - Members of both the House and the Senate have requested funding for local interest projects, many of which are of low or no priority to the State D.O.T.'s in the concerned states.

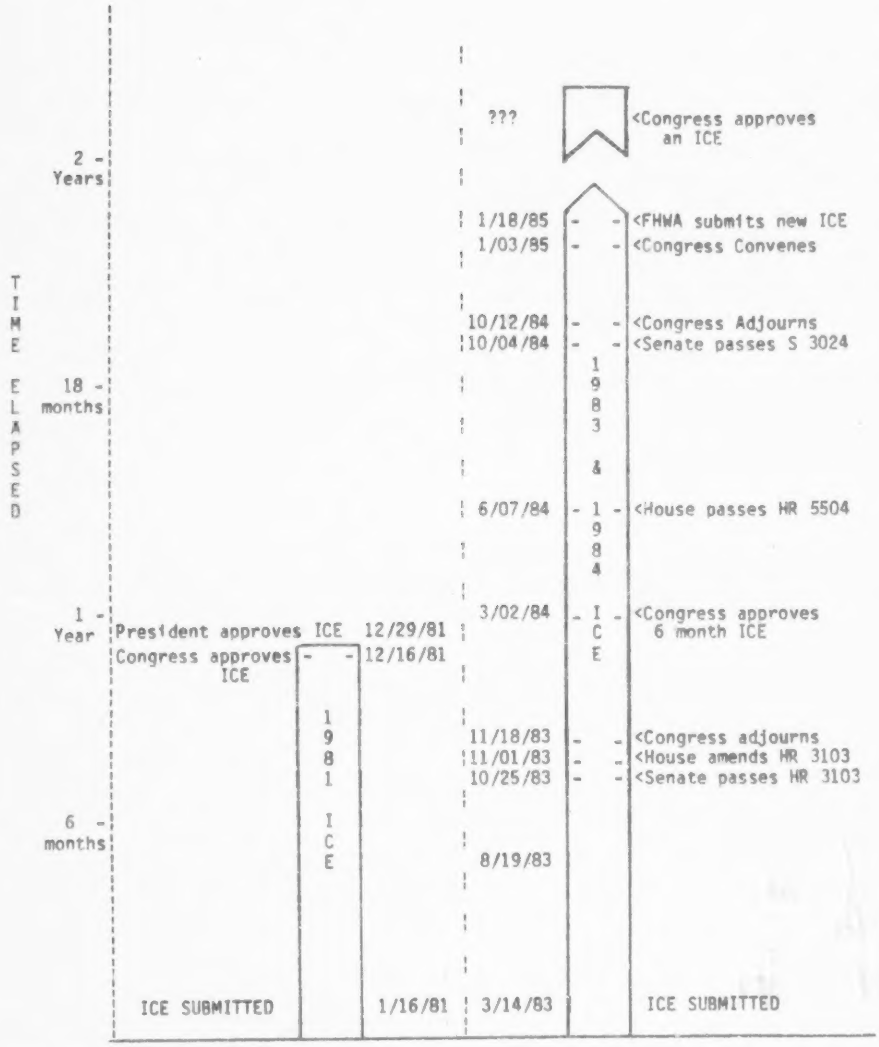
*The Senate will request approximately $170 million in additional funding for these projects, which are limited to a maximum of $25 million per project and require that the state receiving the project must pay 1/2 of the entire project cost.

*The House of Representatives is requesting more than $2 Billion in demonstration project funding, to be paid entirely from the Highway Trust Fund.

85% Minimum Apportionment Funds - The Senate will debate changing the formula for distributing the guaranteed 85% return on contributions made by the states to the Highway Trust Fund. Many rural states would like to receive a greater proportion of their contributions by altering the formula, which currently favors the Eastern, urbanized states.

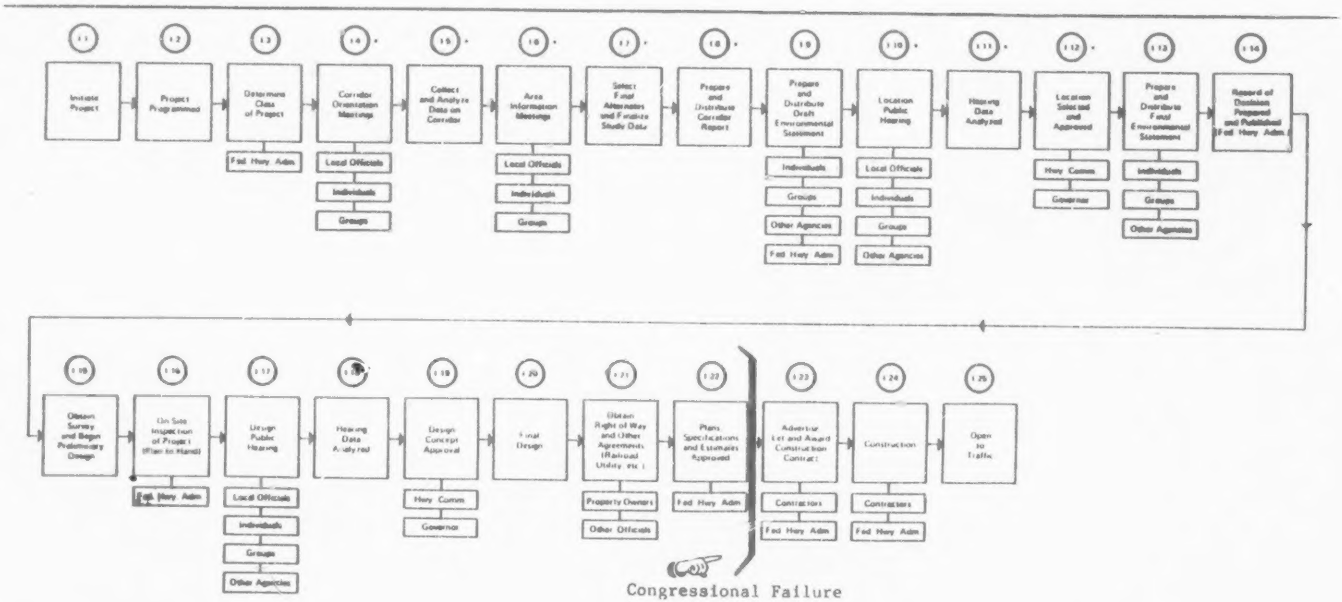
Mass Transit - The House of Representatives is intending to introduce major mass transit legislation that would divert a greater portion of the monies from the Highway Trust Fund away from Highway projects and give it to urban mass transit systems.

APPROVAL OF THE INTERSTATE COST ESTIMATE



DATA FROM FEDERAL HIGHWAY ADMINISTRATION

FLOWCHART OF THE PLANNING PROCESS & STEPS
NEEDED FOR FEDERAL AID HIGHWAY PROJECTS


1.1
Initiate Project
1.2
Project Programmed
1.3
Determine Class of Project
Fed Hwy Adm
1.4
Corridor Orientation Meetings
Local Officials
Individuals
Groups
1.5
Collect and Analyze Data on Corridor
1.6
Area Information Meetings
Local Officials
Individuals
Groups
1.7
Select Final Alternates and Finalize Study Data
1.8
Prepare and Distribute Corridor Report
1.9
Prepare and Distribute Draft Environmental Statement
Individuals
Groups
Other Agencies
Fed Hwy Adm
1.10
Location Public Hearing
Local Officials
Individuals
Groups
Other Agencies
1.11
Hearing Data Analyzed
1.12
Location Selected and Approved
Hwy Comm
Governor
1.13
Prepare and Distribute Final Environmental Statement
Individuals
Groups
Other Agencies
1.14
Record of Decision Prepared and Published (Fed Hwy Adm.)
1.15
Obtain Survey and Begin Preliminary Design
1.16
On Site Inspection of Project (Plan in Hand)
Fed Hwy Adm
1.17
Design Public Hearing
Local Officials
Individuals
Groups
Other Agencies
1.18
Hearing Data Analyzed
1.19
Design Concept Approval
Hwy Comm
Governor
1.20
Final Design
1.21
Obtain Right of Way and Other Agreements (Railroad Utility etc.)
Property Owners
Other Officials
1.22
Plans Specifications and Estimates Approved
Fed Hwy Adm
1.23
Advertise Let and Award Construction Contract
Contractors
Fed Hwy Adm
1.24
Construction
Contractors
Fed Hwy Adm
1.25
Open to Traffic

Congressional Failure
to approve the ICE has
frozen the process here.

INDEPENDENT ELECTRICAL CONTRACTORS INC.
1101 Connecticut Avenue • Suite 700 • Washington, D.C. 20036 (202) 857-1141

STATEMENT OF THE
INDEPENDENT ELECTRICAL CONTRACTORS, INC. (IEC)
BEFORE THE
SENATE COMMITTEE ON SMALL BUSINESS
REGARDING IEC'S
LEGISLATIVE PRIORITIES FOR THE 99TH CONGRESS

FEBRUARY 6, 1985

PRESENTED BY: LARRY BRAZELL, MEMBER
NATIONAL LEGISLATIVE COMMITTEE
INDEPENDENT ELECTRICAL
CONTRACTORS, INC.

My name is Larry Brazell. I'm the owner of Brazell Electric, Inc. in West Hartford, Connecticut. I am appearing today on behalf of the Independent Electrical Contractors, Inc. (IEC), for whom I am currently a member of the National Legislative Committee. I am also a member of the Connecticut Electrical Contractors Association, a statewide group in Connecticut comprising some 250 electrical contractors. The Connecticut Electrical Contractors Association is an affiliated chapter of IEC National.

IEC is a nationwide association of electrical construction firms with members in virtually every state. IEC has over 30 local chapters and a national office in Washington, D.C. IEC has 3,000 contractor members representing over 100,000 employees, and billions of dollars in construction volume in place over the last year. All but a handful of IEC's members are small businesses as defined by standards of the U.S. Department of Labor and the Small Business Administration. Because we represent so many small businesses, whom we consider to be the mainstream of the American business community, we are pleased to present to this committee and to the Congress our legislative priorities for the next session.

I would like to preface my remarks by stating that although businesses in general have been supportive of the actions taken by

THE 98TH CONGRESS AND BY THE ADMINISTRATION ON BEHALF OF NOT ONLY THE CONSTRUCTION INDUSTRY, BUT THE ECONOMY AS A WHOLE, WE DO HAVE SEVERAL VERY GRAVE CONCERNS ABOUT THE DIRECTION BEING TAKEN CURRENTLY BY THE ADMINISTRATION IN REGARDS TO ITS DEALING WITH SMALL BUSINESSES. IT IS BECAUSE WE UNDERSTAND THE CONCERNS OF YOU, MR. CHAIRMAN, AND THE MEMBERS OF YOUR COMMITTEE, THAT WE WOULD LIKE TO REITERATE OUR CONCERN FOR SMALL BUSINESS AND OUR WILLINGNESS TO WORK WITH YOUR COMMITTEE AND THE OTHER APPROPRIATE COMMITTEES OF THE SENATE AND THE HOUSE TO BE CERTAIN THAT THE LEGISLATIVE ACTIONS OF THE 99TH CONGRESS CONTINUE TO CREATE AN ENVIRONMENT IN WHICH SMALL BUSINESSES CAN SURVIVE AND THRIVE.

IN THE 99TH CONGRESS, THE INDEPENDENT ELECTRICAL CONTRACTORS WILL BE EXPENDING THEIR RESOURCES IN MANY AREAS. I WOULD LIKE TO HIGHLIGHT FOR YOU TODAY WHAT IEC CONSIDERS TO BE THE FOUR MOST IMPORTANT SPECIFIC PROGRAMS THAT WILL BE CONSIDERED BY THE CONGRESS IN 1985 AND 1986 AND WHY WE FEEL THAT THESE PROGRAMS DESERVE EITHER THE SUPPORT OR THE OPPOSITION OF THE MEMBERS OF THIS COMMITTEE AND OF THE CONGRESS.

THE FIRST ISSUE THAT I WOULD LIKE TO DISCUSS IS AN ISSUE THAT HAS BEEN BEFORE THE CONGRESS FOR MANY YEARS. AND ALTHOUGH MANY PEOPLE BELIEVE THAT IT IS NO LONGER AN ISSUE, THE MEMBERS OF THE INDEPENDENT ELECTRICAL CONTRACTORS ARE STILL GRAVELY CONCERNED ABOUT THE LACK OF LEGISLATIVE REFORM OR REPEAL OF THE FEDERAL DAVIS-BACON ACT. IT HAS TAKEN OVER TWO YEARS FOR

THIS ADMINISTRATION TO CHANGE THE ACT IN A POSITIVE WAY AND TO REDUCE THE UNNECESSARY FINANCIAL BURDENS ON THE TAXPAYERS CAUSED BY THE DAVIS-BACON ACT. YET WE FIND THAT AFTER TWO YEARS, THE GOVERNMENT IS STILL IN COURT TRYING TO GAIN PERMISSION TO IMPLEMENT THE REGULATIONS FOR THE ADMINISTRATION OF THIS PROGRAM THAT WILL ALLOW THE GOVERNMENT TO GIVE THE TAXPAYER THE MOST FOR HIS FEDERAL CONSTRUCTION DOLLAR.

MEMBERS OF OUR ASSOCIATION HAVE TESTIFIED ON NUMEROUS OCCASIONS BEFORE THIS COMMITTEE, BEFORE THE SENATE LABOR COMMITTEE, AND BEFORE JOINT CONGRESSIONAL COMMITTEES ABOUT THE WASTE AND PAPERWORK BURDENS CAUSED BY THE FEDERAL DAVIS-BACON ACT. THE ADMINISTRATIVE CHANGES THAT HAVE BEEN BROUGHT ABOUT BY THE CURRENT ADMINISTRATION HAVE INDEED HELPED TO LESSEN THE BURDEN ON SMALL BUSINESSES AND ON THE FEDERAL TAXPAYER. HOWEVER, IEC BELIEVES THAT THIS ISSUE CANNOT BE LEFT UP TO THE WHIMS OF A PARTICULAR ADMINISTRATION, OF A PARTICULAR JUDGE OR COURT SYSTEM, OR A PARTICULAR PRESIDENT OR SECRETARY OF LABOR. THE DAVIS-BACON ACT HAS OUTLIVED ITS USEFULNESS TO THE GOVERNMENT, ITS USEFULNESS TO THE TAXPAYER, AND ITS USEFULNESS TO THE WORKERS IT WAS INTENDED TO PROTECT. DURING THE 99TH CONGRESS, THE INDEPENDENT ELECTRICAL CONTRACTORS WILL BE SUPPORTING LEGISLATION TO REPEAL THE FEDERAL DAVIS-BACON ACT OR IN LIEU OF REPEAL, WILL BE SUPPORTING LEGISLATION TO CODIFY THE CHANGES THAT HAVE BEEN BROUGHT FORTH THROUGH THE COURT SYSTEMS BY THE CURRENT ADMINISTRATION.

AS YOU WELL KNOW, AND AS YOU WILL HEAR LATER IN MY STATEMENT, PERHAPS THE MOST PRESSING ISSUE THAT WILL FACE THIS CONGRESS IS

THE REDUCTION OF THE FEDERAL DEFICIT. ONE OF THE WAYS THAT THIS ADMINISTRATION IS ATTACKING THE FEDERAL DEFICIT IS BY PROPOSING BROAD CHANGES IN THE CURRENT TAX STRUCTURE OF THE UNITED STATES. IN THE "MENU" OF TAX OPTIONS PUT FORTH BY THE TREASURY DEPARTMENT IN THEIR PROPOSALS LATE LAST YEAR, THEY LISTED NUMEROUS CHANGES IN THE TAX LAWS THAT WOULD ENHANCE THE REVENUE OF FEDERAL GOVERNMENT FOR FISCAL YEARS 1986, 1987, AND 1988. AMONG THESE PROPOSALS WERE SUCH THINGS AS REPEALING THE THRESHOLD FOR UNEMPLOYMENT COMPENSATION WHICH WOULD SUPPOSEDLY SAVE THE GOVERNMENT TWO BILLION DOLLARS OVER THE TIME PERIOD. THEY WOULD REPEAL REHABILITATION TAX CREDITS ON STRUCTURES TO THE TUNE OF 1.1 BILLION DOLLARS. THE TREASURY DEPARTMENT WOULD DO AWAY WITH THE COMPLETED CONTRACT METHOD OF ACCOUNTING IN THE CONSTRUCTION INDUSTRY AND SUPPOSEDLY SAVE ONE BILLION DOLLARS OVER A THREE-YEAR PERIOD. YET, MR. CHAIRMAN, I WOULD SUBMIT TO YOU THAT RATHER THAN TAKING AWAY ONE OF THE MOST IMPORTANT AND USEFUL RECORDKEEPING AND ACCOUNTING TOOLS IN THE CONSTRUCTION INDUSTRY AND SAVING ONE BILLION DOLLARS, THE GOVERNMENT COULD SAVE ALMOST DOUBLE THAT, APPROXIMATELY 1.8 BILLION DOLLARS OVER A THREE-YEAR PERIOD - BY REPEALING THE DAVIS-BACON ACT AT THE FEDERAL LEVEL. MR. CHAIRMAN, WE ARE NOT TALKING ABOUT CREATING NEW PROGRAMS, CREATING NEW TAX REFORMS, CREATING NEW TAXES. WE ARE TALKING ABOUT REPEALING A LAW THAT HAS OUTLIVED ITS USEFULNESS TO EVERYONE CONCERNED.

THE SECOND ISSUE OF MAJOR CONCERN TO THE INDEPENDENT ELECTRICAL CONTRACTORS DURING THIS SESSION OF CONGRESS IS ONE OF WHICH SENATOR WEICKER IS VERY FAMILIAR. THIS IS THE ISSUE OF UNFAIR COMPETITION BY REGULATED UTILITIES AS IT AFFECTS SMALL BUSINESSES. IN 1983, AT THE IEC LEGISLATIVE CONFERENCE HERE IN WASHINGTON, SENATOR WEICKER TOOK THE LEAD ON EXPLORING THIS ISSUE BY AGREEING TO HOLD HEARINGS BEFORE THIS COMMITTEE TO FURTHER INVESTIGATE HOW DEEPLY THIS ISSUE WAS HURTING SMALL BUSINESSES. IEC SUPPORTS, AND IN FACT LIVES BY THE SPIRIT, OF SMALL BUSINESS BEING ABLE TO PARTICIPATE IN FAIR AND OPEN COMPETITION. HOWEVER, WE BELIEVE THAT UTILITIES ARE GIVEN PROTECTIVE STATUS, IN SOME CASES MONOPOLY STATUS, FREE FROM COMPETITION BECAUSE OF ITS STRUCTURE IN THE ECONOMY. UTILITIES HAVE MARKET ADVANTAGE OVER SMALL COMPANIES THROUGH THEIR ABILITY TO CROSS-SUBSIDIZE, THROUGH THEIR ABILITY TO CREATE GREATER CAPITALIZATION, TO PROVIDE LOANS AND LOAN GUARANTEES OR SUBSIDIES FOR THEIR NEW BUSINESS ACTIVITY AND TO INCORPORATE SOME OF THEIR MANAGEMENT AND OVERHEAD EXPENSES IN A WAY THAT IS NOT AVAILABLE TO SMALLER BUSINESSES. IN ADDITION, THE UTILITIES HAVE INSTANT NAME RECOGNITION, THEY CAN GAIN CREDIT INFORMATION AND THEY HAVE THE ADVANTAGE OF DIRECT INPUT TO POTENTIAL CUSTOMERS' HOMES AND BUSINESSES BECAUSE OF THEIR BILLING PROCEDURES. THEY HAVE ADVERTISING ADVANTAGES OVER SMALL BUSINESSES, AND THEY HAVE FINANCIAL RESOURCES THAT SMALL BUSINESSES CANNOT BEGIN TO COMPETE WITH. IN 1978 AND 1980

WHEN CONGRESS INITIATED THE RESIDENTIAL CONSERVATION SERVICE AND CREATED A COMMERCIAL AND APARTMENT CONSERVATION SERVICE TWO YEARS LATER, . THEY FURTHER ENHANCED THE PROBLEM OF UTILITY INVOLVEMENT IN WHAT SHOULD BE SMALL BUSINESS AND PRIVATE CONTRACTOR WORK BY REQUIRING AUDITS OF MULTI-FAMILY DWELLINGS, COMMERCIAL ESTABLISHMENTS, AND OF COURSE PRIVATE HOMES. THE PROBLEM WITH THE PROGRAM WAS NOT THAT IT WAS TRYING TO SAVE ENERGY, BUT THAT IT FAILED TO INCLUDE ANY PROHIBITION AGAINST UNFAIR COMPETITION FOR SMALL BUSINESSES THAT WERE ALREADY IN THAT PART OF THE INDUSTRY OR WHO WERE ENTERTAINING THE POSSIBILITY OF GETTING INTO THAT PART OF THE INDUSTRY.

IN ORDER TO COMBAT THESE UNFAIR COMPETITION PROBLEMS, THE ALLIANCE FOR UNFAIR COMPETITION WAS FORMED. IEC WAS A FOUNDING MEMBER OF THAT ALLIANCE. THE DEPARTMENT OF ENERGY HAS REOPENED THEIR REGULATIONS FOR IMPLEMENTING THE COMMERCIAL AND APARTMENT CONSERVATION SERVICE AND WILL NOW AT LEAST HOLDING HEARINGS IN THE COMING WEEKS OVER WHETHER OR NOT ANTI-COMPETITIVE REGULATIONS SHOULD BE WRITTEN TO THE OVERALL ADMINISTRATION OF THIS PROGRAM. IEC WILL BE CONTINUING TO PURSUE, THROUGH ALL AVENUES, THE OPPORTUNITIES TO INFORM THE CONGRESS AND THE PUBLIC OF THE PROBLEMS THAT ARE OCCURING THROUGHOUT THE UNITED STATES WHERE PUBLIC UTILITES ARE ENCROACHING ON THE BUSINESS OPPORTUNITIES FOR SMALL CONSTRUCTION, SUPPLY, AND OTHER RELATED FIRMS.

IEC KNOWS THAT THERE ARE THOSE WHO WOULD SAY THAT THIS ISSUE OF UTILITY COMPETITION IS A STATE ISSUE. AND INDEED, SEVERAL STATES HAVE UNDERTAKEN EFFORTS TO BE CERTAIN THAT IF COMPETITION DOES OCCUR BETWEEN MAJOR UTILITIES AND SMALL COMPANIES, THAT THE COMPETITION OCCURS ON A FAIR AND EQUITABLE BASIS. HOWEVER, THERE HAVE BEEN CASES THROUGHOUT THE UNITED STATES WHERE LOCAL UTILITIES, DESPITE AGREEMENTS NOT TO COMPETE, HAVE IN FACT CONTINUED TO ENCROACH ON THE SMALL BUSINESS MARKET. AN IEC MEMBER IN ATLANTA, GEORGIA HAD GAINED AGREEMENTS FROM HIS LOCAL UTILITY NOT TO DO CERTAIN TYPES OF SITE LIGHTING THAT HAD ALWAYS BEEN DONE BY PRIVATE CONTRACTORS, BUT HAD RECENTLY BEEN UNDERTAKEN BY THE PUBLIC UTILITY. AFTER A "GRACE" PERIOD, THE CONTRACTORS FOUND THAT THE UTILITY WAS ONCE AGAIN INSTALLING SITE LIGHTING THAT HAD BEEN PRIVATE CONTRACTOR WORK. IN FACT, OUR MEMBER EVEN HAPPENED TO WALK INTO A MEETING WHERE REPRESENTIVES OF THE LOCAL UTILITY WERE APPROACHING AN OWNER ABOUT THE POSSIBILITY OF HAVING THE UTILITY AND ITS SUBSIDIARY COMPANIES DO THE SITE LIGHTING AS OPPOSED TO HAVING THE WORK SENT OUT AND PUT UP FOR BIDS TO PRIVATE CONTRACTORS NORMALLY DOING THAT WORK. IT IS THIS TYPE OF VIOLATION OF GOOD FAITH AND FAIR COMPETITION THAT IEC WOULD LIKE ADDRESSED AT THE FEDERAL LEVEL SO THAT THE FEDERAL GOVERNMENT CAN ESTABLISH SOME GUIDELINES THAT STATES CAN USE IN DEALING WITH THEIR UTILITIES.

THE THIRD ISSUE THAT IEC WILL BE HIGHLIGHTING IN THEIR LEGISLATIVE AGENDA FOR THIS YEAR IS AN ISSUE THAT YOU MAY NOT BE AS FAMILIAR WITH. THIS IS THE ISSUE OF BID LISTING, OR THE REQUIREMENT OF HAVING PRIME CONTRACTORS WHO ARE AWARDED

FEDERAL CONTRACTS FOR CONSTRUCTION SUBMIT AS PART OF THEIR BID THE NAMES OF THE SUBCONTRACTORS WITH WHOM THEY (THE BIDDER), IF AWARDED THE CONTRACT, WILL SUBCONTRACT FOR THE PERFORMANCE OF THE CATEGORIES OF WORK DESIGNATED ON THE LIST SUBMITTED WITH THE BID.

THE PRACTICE OF BID SHOPPING OR BID PEDDLING HAS BEEN COMMON IN THE CONSTRUCTION INDUSTRY FOR MANY YEARS. THIS IS A PRACTICE WHEREIN THE PRIME CONTRACTOR, AFTER BEING AWARDED A FEDERAL CONSTRUCTION PROJECT RE-EVALUATES THE BIDS HE RECEIVED FROM SUBCONTRACTORS AND ON WHICH HE BASED HIS BID ON THE PROJECT. THE GENERAL CONTRACTOR THEN GOES BACK TO OTHER SUBCONTRACTORS TO SEE IF ANY OF THEM WILL OFFER A LOWER PRICE THEN THE ONES ON WHOM HE BASED HIS BID. THIS PRACTICE NOT ONLY CAUSES THE OBVIOUS PROBLEMS IN RELATIONSHIPS BETWEEN GENERAL CONTRACTORS AND SUBCONTRACTORS, IT HAS AN OVERFLOW EFFECT ON THE RELATIONSHIPS BETWEEN SUBCONTRACTORS AND THEIR SUPPLIERS, AND PERHAPS MOST IMPORTANTLY, IT HAS AN IMPACT ON THE RELATIONSHIPS BETWEEN CONTRACTORS WITHIN THE SAME TRADES.

IEC WILL BE SUPPORTING LEGISLATION WHICH WE HOPE TO HAVE INTRODUCED IN THE 99TH CONGRESS THAT WILL MANDATE THAT PRIME CONTRACTORS ON FEDERAL PROJECTS SUBMIT THIS PROPOSED AND REQUIRED LIST OF SUBCONTRACTORS. THE LEGISLATION THAT WE ARE HELPING TO INTRODUCE INTO THE CONGRESS WILL LIST NOT ONLY THE PROPOSED THRESHOLD FOR PROJECTS UNDER WHICH BID LISTING WILL BE REQUIRED, BUT WILL ALSO LIST THOSE CONDITIONS UNDER WHICH A SUCCESSFUL CONTRACTOR ON A FEDERAL JOB CAN CHANGE

A SUBCONTRACTOR AFTER BEING AWARDED THE BID. IEC BELIEVES THIS ACT WILL NOT ONLY SAVE A GREAT DEAL OF TIME AND EFFORT EXPENDED WITHIN THE CONSTRUCTION INDUSTRY WHEN THE PRACTICE OF BID SHOPPING AND BID PEDDLING IS IN EFFECT, BUT WILL ALSO SAVE THE FEDERAL GOVERNMENT TIME AND MONEY SPENT LITIGATING CLAIMS AGAINST CONTRACTORS WHO ARE AWARDED CONTRACTS AND THEN CANNOT PERFORM THE WORK AT THE PRICE AND CONDITIONS AS CALLED FOR IN THE CONTRACT.

ONCE AGAIN, THERE ARE MANY WHO WOULD CONSIDER THIS TO BE A STATE ISSUE, AND ONCE AGAIN WE WOULD SAY THAT YES, SEVERAL STATES DO HAVE LAWS PERTAINING TO BID LISTING AND HAVE MET WITH MIXED RESULTS ON THEIR EFFORTS. MOST STATES WILL FOLLOW THE LEAD OF THE FEDERAL GOVERNMENT IN THIS AREA, AND WE BELIEVE THE PLACE TO START IS AT THE FEDERAL LEVEL.

THERE ARE OTHER AREAS OF CONCERN TO IEC IN THE NEXT CONGRESS AND THESE ARE COVERED IN DETAIL IN THE WRITTEN TESTIMONY WE WILL BE SUBMITTING BEFORE THIS COMMITTEE. FOREMOST AMONG THESE OTHER ISSUES IS,AS I'VE SAID BEFORE, THE PROPOSED CHANGES IN THE TAX LAWS OF THE UNITED STATES. THE TAX REFORM ACT OF 1984, WHICH WAS PASSED IN THE LAST SESSION OF CONGRESS HAS MANY PROVISIONS IN IT THAT, IN RETROSPECT, ARE DANGEROUSLY HARMFUL TO SMALL BUSINESSES. IN THE NEXT FEW DAYS, THERE WILL BE NUMEROUS HEARINGS HELD ON THE NEW REGULATIONS FOR SUBSTANTIATION OF BUSINESS USE AND INVESTMENT USE OF LISTED PROPERTIES AND AUTOMOBILES. THERE ARE NEW REGULATIONS AFFECTING LIMITATION ON THE AMOUNTS AND AVAILABILITY OF DEPRECIATION AND INVESTMENT TAX

CREDIT ON AUTOMOBILES, AND MIXED PERSONAL AND BUSINESS USE PROPERTY. THESE ARE BUT TWO OF THE PROVISIONS IN THE 1984 TAX LAW THAT IEC FEELS WERE ILL-CONCEIVED AND WE HOPE WILL BE REPEALED DURING THIS SESSION OF THE CONGRESS. IN THE RELATED AREA OF TAX REFORM AS PUT FORTH IN THE TREASURY DEPARTMENT PROPOSALS, THERE ARE ANY NUMBER OF PROPOSALS WITHIN THAT PLAN THAT WOULD CAUSE GRAVE HARM TO THE ABILITY OF SMALL BUSINESSES SUCH AS IEC MEMBER COMPANIES TO CONTINUE TO COMPETE ON A FAIR BASIS IN THE MARKET PLACE. AMOUNG THE MORE INJURIOUS COMPONENTS OF THE TREASURY PLAN ARE THEIR PROPOSED ELIMINATION OF THE COMPLETED CONTRACT METHOD OF ACCOUNTING, THEIR NEW PROPOSAL FOR REPLACING THE ACCELERATED COST RECOVERY SYSTEM, THEIR REPEALING OF THE TAX CREDITS FOR NEW INVESTMENT, THEIR PROPOSAL TO TAX CERTAIN FRINGE BENEFIT PROGRAMS, AND THE LONGER LIST OF TAX REFORMS THAT WOULD BE INJURIOUS TO INDIVIDUAL MEMBERS OF IEC AS WELL AS TO THEIR COMPANIES. IEC REALIZES THAT THE TAX REFORM ACTIVITIES OF THE CONGRESS WILL BE A LONG AND VIGOROUSLY FOUGHT AFFAIR, AND WE INTEND TO GIVE INPUT THROUGH THIS COMMITTEE AND THE OTHER APPROPRIATE COMMITTEES AS TO HOW THOSE PROPOSALS WILL AFFECT OUR MEMBERS.

SOME OF THE OTHER ISSUES WE WILL BE CONCERNED WITH THIS YEAR INCLUDE: AMENDING THE WALSH-HEALEY ACT TO ALLOW FOR WORK WEEKS OF FOUR 10-HOUR DAYS; AMENDING THE MILLER ACT TO BE CERTAIN THAT CONTRACTORS ON FEDERAL PROJECTS ARE PROPERLY

BONDED AND PROTECTED; AND PROPOSALS TO EXTEND THE EQUAL ACCESS TO JUSTICE ACT TO ALLOW CONTRACTORS TO RECOVER DAMAGES IN LITIGATION OVER FEDERAL PROJECTS.

FINALLY, MR. CHAIRMAN, IEC WOULD LIKE TO GO ON RECORD AS SAYING THAT WE ARE VERY CONCERNED ABOUT THE PROPOSALS TO DO AWAY WITH THE FEDERAL SMALL BUSINESS ADMINISTRATION. ALTHOUGH SOME MEMBERS OF IEC BELIEVE THAT THE SMALL BUSINESS ADMINSTRATION PROGRAMS IN THEIR AREA HAVE ADVERSELY AFFECTED THEIR MARKET, IEC IN GENERAL BELIEVES THAT THE WATCHDOG AND ADVOCACY ROLES OF THE SMALL BUSINESS ADMINISTRATION ARE VALUED PARTS OF THE SMALL BUSINESS COMMUNITY. AND WHILE WE WOULD HAVE NO OBJECTION TO WORKING WITH THIS COMMITTEE, OR ANY OTHERS, IN RE-EVALUATING SOME OF THE PROGRAMS SPONSORED BY SBA, WE DO BELIEVE THAT SBA'S ROLE IS AN IMPORTANT ONE AS A SEPARATE ENTITY WITHIN THE FEDERAL GOVERNMENT AND WE WOULD HOPE THAT A RESTRUCTURING RATHER THAN AN ABOLITION OF THE SMALL BUSINESS ADMINISTRATION WOULD BE UNDERTAKEN, IF, IN FACT, A CHANGE IN SBA IS TO OCCUR.

ONCE AGAIN, IEC WOULD LIKE TO THANK THE COMMITTEE FOR INVITING THEM TO PARTICIPATE IN THESE HEARINGS. WE LOOK FORWARD TO WORKING CLOSELY WITH THE STAFF OF THIS COMMITTEE AND PURSUING THE GOALS OF ALL OF THE SMALL BUSINESS ORGANIZATIONS IN THE UNITED STATES.

THANK YOU.

Statement of

J. Richard Troll

Executive Director

Association of Independent Corrugated Converters

before the

Committee on Small Business

United States Senate

Washington, D. C.

February 6, 1985

Senator Weicker, Senator Bumpers, members of the Committee.

Thank you for this opportunity to make a contribution to the legislative agenda of the Senate Committee on Small Business. My name is Richard Troll. I am the Executive Director of the Association of of Independent Corrugated Converters. The AICC is a trade association which represents a majority of the approximate seven hundred independent corrugated container manufacturers in the United States. Independent in this instance means not owned by and not owning a containerboard paper mill. Our membership consists of closely held corporations with annual sales in the five to fifty million dollar category. We are not the Union Camps, Weyerhaeusers and Meads of this world. Corrugated containers represent the largest part of the packaging industry with sales in excess of ten billion dollars annually. The independent segment represents about twenty-five percent of this number. Corrugated manufacturing is essentially a job shop industry. All container plants, independent or otherwise, produce, design and deliver products on an as-needed basis and each serve about a hundred-mile radius from their location. There are no product-user economies of scale which result from numbers of plants or plant size. State-of-the-art manufacturing technology is available to all who can afford it.

Our concerns today relating to concentration, a free market, predatory pricing and dual distribution remain the same as when we were founded ten years ago. The only thing which has changed is an increased degree of concern. Within the past eighteen months two large integrated companies -- Continental Can and St. Regis -- have been absorbed by a combination of already large, integrated forest product companies. Currently fewer than thirty corporations control approximately seventy-five percent of the market and more than seven hundred independent companies compete for the remaining twenty-five percent. Thus the circle grows smaller and the potential for problems grows larger.

Independent converters must obtain their raw material (containerboard) from integrated companies who own box plants and with whom they compete for the container business. Currently there are only two mills who do not operate their own box plants. These two combined could not supply a significant part of the raw material needs of the independent converters.

Integrated forest product companies have two major competitive advantages over the independent converter and both are attained before the actual manufacture of a corrugated box. First they are granted a timber depletion allowance for what is essentially a renewable resource, and second they are allowed capital gains tax classification for the transfer and sale of pulpwood from wholly-owned subsidiaries. Neither of these is illegal, but both result in an effectively reduced tax rate. This translates into reduced raw material costs and provides the potential for the predatory pricing of boxes. What we would like to see is a form of legislation which addresses the issue of actual costs relating to box manufacturing. These elements were contained in several bills which have been considered in the past and were most recently addressed in the Fair Competition Act of 1984 (H.R. 5237). This bill would have amended section three of the Robinson-Patman Act to define "cost of production" in order to determine whether goods are being sold below cost in order to eliminate competition.

The corrugated industry is a relatively complicated mix of a capital, labor intense, service-oriented business. It is an important part of the distribution system in the United States. Its customers come in all sizes, and their needs are constantly changing. Independent converters have always been in the forefront of package innovation and marketing acumen. All we ask is the right to succeed or fail based on individual ability -- not unfair advantage.

Thank you for your interest. I would be happy to try to answer any questions you might have. I offer the cooperation of our membership in helping to create a climate of a genuinely free and fair segment of commerce -- a climate which we all desire.

Survey of National Priorities of U.S. Smaller Businesses

submitted by

Donald Rappaport
National Director of Smaller Business Services
Price Waterhouse

to the

Committee on Small Business
U.S. Senate

February 6, 1985

Relief from rising payroll taxes and cuts in federal spending lead the small business community's list of public policy priorities, according to an informal survey recently conducted by Price Waterhouse's National Office of Smaller Business Services.

This list was developed at a Small Business National Issues Conference (SBNIC), sponsored by the American Institute of Certified Public Accountants, the National Federation of Independent Business, the National Small Business Association, Small Business United, and the U.S. Chamber of Commerce. Over 100 small business executives representing 5 million small business members of these organizations met at the conference, held last June in Washington, D.C. The conference identified 25 priority issues and proposed about 80 related actions. Readers of the Price Waterhouse Business Review were asked to respond to these. The Price Waterhouse survey produced 874 responses from a broad cross-section of smaller businesses.

Payroll Taxes

"Payroll taxes have a disproportionate impact on small business," according to the Conference report, "because small firms are generally labor intensive and a large portion of their total payroll is subject to these taxes." It is estimated that payroll taxes now provide 33 percent of federal revenues. The growth in payroll taxes, however, was considered perhaps even more significant. Between 1970 and 1990, 9 Social Security rate increases totalling 60 percent, 19 Social Security base increases amounting perhaps to 677 percent, 3 federal unemployment tax (FUTA) rate increases amounting to 94 percent, and 3 FUTA base increases adding up to 133 percent have occurred or are scheduled. In the view of the conference, "payroll taxes must become part of the broad tax policy debate. Despite immediate as well as long-term problems of funding Medicare, Social Security, and unemployment compensation reserves, Congress must be convinced that the small business community can no longer support this continuing upward spiral." About 82 percent of respondents to the survey opposed any further increases in payroll taxes.

Asked about the relationship between payroll taxes and economic growth, 79 percent of the respondents felt that it does not make sense to use total employment as a tax base. They agreed with a conference report that "financing government spending by raising taxes on employees artificially discourages the hiring of people by making them more expensive relative to equipment." More generally, the great majority (88 percent) of respondents felt that the government should avoid policies that distort the free market, such as subsidies and penalties that handicap some types of economic activity, such as labor-intensive smaller business. It was noted that "recent research recognizes that smaller enterprises are a major resource that must be considered as a significant partner" in pursuing the nation's economic and social goals.

Much of the concern about payroll taxes focused on unemployment compensation. The June 1984 conference expressed an interest in controlling unemployment compensation costs and in setting the level of unemployment benefits to provide subsistence rather than income maintenance. Several proposals received particularly strong support from survey respondents. The individual states should move to control cost increases by improving experience rating and targeting benefits. In addition, Congress should pass legislation to exempt employers from paying unemployment taxes for employees who are never eligible for benefits, such as corporate officers.

Finally, survey respondents favored changes in Internal Revenue Service (IRS) regulations, designed to ease the burden of payroll taxes on small firms while in no way reducing the payroll taxes of the business owner. In particular, it was felt that IRS notification of penalty and taxes past due should include a detailed account of computations. Some 85 percent supported this proposal.

Federal Spending and the Deficit

While Americans apparently agree that federal spending should be cut, there seem to be major differences of opinion on how this can be done. Many in Congress feel that the entitlements (e.g., Social Security) and military programs provide the only remaining opportunities for major savings. The Small Business National Issues Conference and results of the Price Waterhouse survey, however, indicate a widespread belief that there is simply a lot of waste and, hence, potential savings throughout government.

"Small business supports intensive effort to eliminate government inefficiency and waste," the conference reported. The President's Commission on Cost Containment (Grace Commission), which has offered recommendations for eliminating what it sees as significant waste, aroused the interest of participants. The conference suggested that "these savings can be effected with and without legislation and could significantly reduce the Federal budget deficit." Over 87 percent of survey respondents favored implementation of appropriate Grace Commission proposals. There was considerable support for a specific implementation program. At least 76 percent of the respondents favored each of three proposed steps. First, the President should direct affected departments and agencies to take appropriate administrative action to implement cost saving recommendations and report on their progress by August 31, 1985. Second, the Office of Management and Budget should monitor the implementation plans of the departments and agencies, and suggest appropriate steps to accomplish the intent of the recommendations. Third, Congress should review the Grace Commission report and report appropriate implementing legislation by August 31, 1985.

A majority of respondents favored various approaches toward curbing government spending, such as permanently adjusting cost of living adjustments to less than consumer price index increases; passing a constitutional amendment to require a balanced budget; limiting federal spending to a percentage of gross national product; and giving the President constitutional authority to veto line items in appropriation bills. Some 72 percent favored an immediate one-year freeze on spending.

Respondents were emphatic in insisting that the federal deficit be lowered through cuts in government spending. Almost 88 percent agreed that tax increases must not be used by Congress to offset failures at implementing spending reductions.

Other Priorities

Government procurement. "Current government procurement practices result in the waste of billions of dollars annually and the denial of opportunity for millions of small businesses to participate in Federal procurements," a conference report charged. It went on to note that "numerous studies have consistently confirmed that increasing the share of procurements from small business will result in substantial savings to the Federal government." These savings are expected to result from increased competition and responsiveness to the special needs of smaller firms.

About 86 percent of respondents to the Price Waterhouse survey supported full and prompt payment for progress payments and for final payments on work satisfactorily completed. This includes direct federal contracts and contracts with prime contractors, who should provide the same payment terms in their subcontracts. The timely collection of receivables can, of course, be critical to a small firm's survival.

About 78 percent favored Congressional passage of legislation addressing competition in spare parts procurement. Congress has responded to this sentiment.

Recent enactment of the Small Business and Federal Procurement Competition Enhancement Act of 1984 promises to make it easier for smaller businesses to compete for federal government contracts. Government contracting offers attractive and predictable profits, cost control benefits, research and development opportunities, and an enormous market--1983 federal contract awards totalled $168 billion.

Product liability. Citing inconsistent and conflicting state laws and court decisions, the conference reported that "businesses at all levels of the manufacturing, distribution and service chain are incurring high legal costs and unpredictable liability awards. The awards often penalize parties that were not actually responsible for any injuries incurred." Around 80 percent of survey respondents favored a national law that would define the obligations of manufacturers, distributors, and other parties in product liability for products they sell or service; and make only the party responsible for any injury from a product or service liable for that injury.

Additional Proposals

When ranked in order of overall approval, four additional proposals fall within the highest approval quartile:

- The Equal Access to Justice, Regulatory Flexibility and Paperwork Reduction Acts should be strongly enforced and specifically extended to include the IRS and Defense procurement system.
- In the area of tax simplification, it is necessary to legislate clear "safe harbor" guidelines for determining if a small business is at risk from the IRS asserting that debt is equity.
- Accord small business equal treatment in utility rate-base cases.
- Health care cost containment should be promoted by encouraging states to enact legislation requiring hospitals and health care providers to charge all patients on the same equitable basis and by forbidding the shifting of costs from one group to another.

SUMMARY OF THE TOP 15 PRIORITIES-NATIONWIDE

Heading	0	1	2	3	4	5	Total	Rank
				(SUMMARY OF RESPONDENTS)				
	(N/A)	(Under $1M)	($1-10M)	($10-50M)	($50-100M)	($100+M)		
Sales	2	231	273	229	68	71	874	2.40
Percentage	0.2	26.4	31.2	26.2	7.8	8.1		
	(N/A)	(Manuf.)	(Whol./Ret.)	(Fin./Ins./RE)	(Services)	(Other)		
Activity	2	286	111	155	252	68	874	2.66
Percentage	0.2	32.7	12.7	17.7	28.8	7.8		
	(N/A)	(Pub. Corp.)	(Priv. Corp.)	(S Corp.)	(Partner.)	(Sole Pro.)		
Type of Firm	2	133	521	92	52	74	874	2.33
Percentage	0.2	15.2	59.6	10.5	5.9	8.5		
	(N/A)	(1-19)	(20-99)	(100+)	(N/A)	(N/A)		
Employment	2	260	232	377	1	2	874	2.10
Percentage	0.2	29.7	26.5	43.1	0.1	0.2		
				(RANKING OF PRIORITIES)				
		(Strong. Oppose)		(Indifferent)		(Strong. Favor)		
4D(4) (Payroll tax deposit rules should be changed--Notification by IRS of penalty and taxes past due should include a detailed account of computations)	0	3	7	123	142	599	874	4.52
Percentage	0.0	0.3	0.8	14.1	16.2	68.5		
1F (Eliminate government inefficiency/waste by implementing appropriate Grace Commission proposals)	0	6	10	96	202	560	874	4.49
Percentage	0.0	0.7	1.1	11.0	23.1	64.1		
1E (Tax increases must not be used by Congress to offset failures to implement [deficit reduction])	0	20	27	62	171	594	874	4.48
Percentage	0.0	2.3	3.1	7.1	19.6	68.0		
12B (Government should avoid policies that distort competitive markets)	0	10	25	72	218	549	874	4.45
Percentage	0.0	1.1	2.9	8.2	24.9	62.8		
6D (Government procurement--Full and prompt payment for progress and final payments on work satisfactorily completed)	0	1	2	117	237	517	874	4.45
Percentage	0.0	0.1	0.2	13.4	27.1	59.2		
5A (Stop any further increase in payroll taxes)	0	23	32	104	153	562	874	4.37
Percentage	0.0	2.6	3.7	11.9	17.5	64.3		
7A (Grace Commission--Presidential order to implement and report progress by 8/31/85)	0	6	10	146	203	509	874	4.37
Percentage	0.0	0.7	1.1	16.7	23.2	58.2		
23D (Unemployment compensation--States should take action to control cost increases by improving experience rating and targeting of benefits, rather than raising taxes)	0	8	10	107	277	472	874	4.37
Percentage	0.0	0.9	1.1	12.2	31.7	54.0		
11A (Product liability--Nationwide definition of obligations for manufacturers, distributors and other parties)	2	16	17	109	235	495	874	4.35
Percentage	0.2	1.8	1.9	12.5	26.9	56.6		
23A (Unemployment compensation--Do not forgive repayment of federal loans)	0	14	30	122	199	509	874	4.33
Percentage	0.0	1.6	3.4	14.0	22.8	58.2		
23E (Exempt employers from paying unemployment compensation taxes for employees who are never eligible for benefits)	0	39	33	101	151	550	874	4.30
Percentage	0.0	4.5	3.8	11.6	17.3	62.9		
7B (Grace Commission--OMB monitor and help to accomplish the intent)	0	6	9	174	243	442	874	4.27
Percentage	0.0	0.7	1.0	19.9	27.8	50.6		
6A (Government procurement--Pass amendment to 1985 Defense Authorization Act for competition in spare parts procurement)	0	9	9	175	244	437	874	4.25
Percentage	0.0	1.0	1.0	20.0	27.9	50.0		
7C (Grace Commission--Congress review and report implementing legislation by 8/31/85)	0	17	11	174	208	464	874	4.25
Percentage	0.0	1.9	1.3	19.9	23.8	53.1		
12D (Financing government by raising employee taxes discourages hiring and should be stopped)	0	23	51	105	230	465	874	4.22
Percentage	0.0	2.6	5.8	12.0	26.3	53.2		

Price Waterhouse

BUSINESS REVIEW

A newsletter
for smaller businesses and entrepreneurs
designed to provide
accurate and helpful information

National Office of Smaller Business Services, 1801 K St., N.W. Washington, D.C. 20006.

from Donald Rappaport,
National Director

Dear *Business Review* Reader:

Re: Small Business Issues

In June 1984, Small Business United sponsored the Small Business National Issues Conference along with the American Institute of Certified Public Accountants, the U.S. Chamber of Commerce, the National Federation of Independent Business, and the National Small Business Association. Over 100 small business executives representing 5 million small business members of these organizations met in Washington, D.C. to agree upon national issues and a program of advocacy. Some 25 priority issues were identified and about 80 related "actions" were proposed. These are listed below.

Your voice may have been heard through your membership in the above organizations. As clients and friends of Price Waterhouse, we would like to publicize your opinions. Hence, we are asking you to participate in this survey by circling the number that describes your opinion on each proposed action. Your anonymity is assured, though please include your ZIP Code so we can develop area comparisons.

* * *

My ZIP Code is ____________.

	Strongly Favor/ Agree		Indif-ferent		Strongly Oppose/ Disagree
Issue #1 The Federal Deficit					
a. An immediate one-year freeze of FY '85 spending at FY '84 levels	5	4	3	2	1
b. Permanently adjust Cost of Living Adjustments to less than Consumer Price Index increases	5	4	3	2	1
c. A constitutional amendment to require a balanced budget	5	4	3	2	1
d. Limit Federal spending to a percentage of Gross National Product (GNP)	5	4	3	2	1
e. A constitutional amendment giving the President line-item veto power of appropriation bills	5	4	3	2	1
f. Eliminate government inefficiency/waste by implementing appropriate Grace Commission proposals	5	4	3	2	1
g. Eliminate direct or indirect government competition with small business	5	4	3	2	1
h. Tax increases must not be used by Congress to offset failures to implement above actions	5	4	3	2	1
i. Tax indexation must not be eliminated or delayed	5	4	3	2	1
Issue #2 Government competition with private sector					
a. Enact federal legislation to require procurement from the private sector	5	4	3	2	1
b. Deny preferences (e.g., tax exemptions) to the commercial activities of non-profits and regulated industries	5	4	3	2	1

1984-5

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	Strongly Favor/ Agree		Indif-ferent		Strongly Oppose/ Disagree
Issue #3 Effective tax rates					
a. Replace the present corporate tax graduation schedule with a graduated rate scale, specifying a graduated schedule up to $500,000	5	4	3	2	1
b. The tax credit limitation on used equipment should be increased in the near term to $50,000	5	4	3	2	1
c. In the long term eliminate distinction between new and used equipment for investment tax credit	5	4	3	2	1
d. Repeal the accumulated earnings tax	5	4	3	2	1
e. The proposed double taxation of corporation liquidation (Subchapter C Reform — Repeal of Sections 336 and 337) is without merit and should be opposed	5	4	3	2	1
f. The bias in the tax code which provides a tax advantage for mergers with larger businesses should be eliminated	5	4	3	2	1
Issue #4 Simplification of tax rules and regulations					
a. Clear legislative guidelines should be enacted vis-a-vis IRS assertions that debt is equity	5	4	3	2	1
b. Safe harbour guidelines should be adopted to provide certainty to small business	5	4	3	2	1
• $1 million exemption for inside debt	5	4	3	2	1
• 5-year exemption for new businesses	5	4	3	2	1
• 5:1 inside debt-to-equity ratio allowed	5	4	3	2	1
• Use fair market value to determine net assets and debt-to-equity ratio	5	4	3	2	1
c. In absence of clear legislative guidelines, repeal Section 385 of IRS code	5	4	3	2	1
d. Payroll tax deposit rules should be changed	5	4	3	2	1
• Amend IRS regulations changing threshold payroll deposit from $3,000 to $7,500	5	4	3	2	1
• Consider employers with gross annual deposits of less than $75,000 to have complied if the deposit is not less than 90% of the taxes for the period	5	4	3	2	1
• Penalties should not be assessed for short-fall owed for first penalties in a fiscal year when the gross payroll rules change due to increases in total payroll	5	4	3	2	1
• Notification by IRS of penalty and taxes past due should include a detailed account of computations	5	4	3	2	1
e. Simplified accounting and inventory valuation rules to foster capital formation and retention	5	4	3	2	1
• Increase to $10 million in annual sales the limitation for firms who can use simplified LIFO pooling rules	5	4	3	2	1
• Permit any small business to use a single inventory pool and a single price index for determining the LIFO deferral	5	4	3	2	1
• Use of cash method of accounting if gross sales are less than $3 million	5	4	3	2	1
Issue #5 Payroll taxes					
a. Stop any further increase in payroll taxes	5	4	3	2	1
Issue #6 Government procurement					
a. Pass amendment to 1985 Defense Authorization Act for competition in spare parts procurement	5	4	3	2	1
b. Increase incentives for procurement officers/prime contractors to contract with smaller business	5	4	3	2	1

	Strongly Favor/ Agree		Indif- ferent		Strongly Oppose/ Disagree
c. Support Small Business Innovation Research (SBIR) program	5	4	3	2	1
d. Full and prompt payment for progress and final payments on work satisfactorily completed	5	4	3	2	1
Issue #7 Government savings (Grace Commission)					
a. Presidential order to implement by 12/31/84 and report progress by 8/31/85	5	4	3	2	1
b. OMB monitor and help to accomplish the intent	5	4	3	2	1
c. Congress review Commission Report by 12/31/84; report implementing legislation by 8/31/85	5	4	3	2	1
Issue #8 Small Business Participating Debentures					
a. Legislate SBPDs, which would provide lenders a fixed rate of interest plus non-ownership participation in earnings. Participating share of earnings would be taxed to investors as long-term capital gain, but deductible by issuing company.	5	4	3	2	1
Issue #9 International trade					
a. Give credit worthy banks serving small business greater discretionary lending authority to facilitate small business export sales with financing under $3 million	5	4	3	2	1
b. Eximbank direct lending for small business sales to countries where commercial banks are unwilling to participate	5	4	3	2	1
c. Standardize Eximbank commercial risk coverage at a level which will make export financing attractive to commercial banks serving small business	5	4	3	2	1
d. Allow states to supplement commercial risk coverage	5	4	3	2	1
e. Congress should have strong oversight role to insure Eximbank carries out its small business mandate	5	4	3	2	1
f. Amend the Foreign Sales Corporation legislation (FSC replacing DISC) to include service firms; allow small businesses with up to $10 million in gross export receipts to use the small FSC exception to foreign requirements for a 5-year transition period; then impose a $5 million ceiling	5	4	3	2	1
g. Create a Cabinet level Department of International Trade to consolidate export promotion and trade functions	5	4	3	2	1
h. Expand export incentives such as Export Trading Companies and the Carribean Basin Initiative	5	4	3	2	1
Issue #10 Regulation and paperwork					
a. The Equal Access to Justice, Regulatory Flexibility and Paperwork Reduction Acts should be strongly enforced and extended specifically to include the IRS and Defense Procurement system	5	4	3	2	1
b. Make these Acts permanent law	5	4	3	2	1
c. The "substantially justified" test of the EAJA should be applied to all of an agency's activities, not just the agency's position in court	5	4	3	2	1
Issue #11 Product liability laws					
a. Nationwide definition of obligations for manufacturers, distributors and other parties	5	4	3	2	1
b. Make only the party responsible for any injury liable	5	4	3	2	1
Issue #12 Industrial policy					
a. Government should not play central planner	5	4	3	2	1
b. Government should avoid policies that distort competitive markets	5	4	3	2	1

	Strongly Favor/ Agree		Indif- ferent		Strongly Oppose/ Disagree
c. The federal government is not the appropriate vehicle for training or retraining workers	5	4	3	2	1
d. Financing government by raising employee taxes discourages hiring and should be stopped	5	4	3	2	1
e. Tax credits for investment should apply equally to people and machines so not to bias investment decisions	5	4	3	2	1
f. Government programs should not discriminate on the basis of business size	5	4	3	2	1
Issue #13 Federal estate and gift taxes					
a. Oppose efforts to repeal or postpone the increase in the United Estate Tax Credit or postpone reduction in the estate and gift tax rates	5	4	3	2	1
b. Adjust these rates to reflect inflation	5	4	3	2	1
c. Repeal all Federal estate and gift taxes	5	4	3	2	1
Issue #14 "Davis-Bacon" government construction contracts					
a. Repeal the Davis-Bacon Act and those provisions in program statutes which refer to the Davis-Bacon Act in establishing prevailing wage standards. Until the Davis-Bacon Act is repealed, legislation should be enacted providing for an increase in the Act's contract threshold to at least $5 million	5	4	3	2	1
Issue #15 Small business access to equity capital					
a. Allow depository institutions to establish restricted funds to invest in qualified small business equities, with protection of the firm's ownership and authority. Investment appreciation would be taxed as a long-term capital gain; dividends on bank-held stock would be tax exempt and net losses would be allowable as deductions	5	4	3	2	1
Issue #16 Taxation of capital gains from qualifying small business					
a. Allow for a deferral of capital gains taxes on the sale of any capital asset or investment if the proceeds are reinvested in the common stock of a small business	5	4	3	2	1
Issue #17 Tax credit for labor-intensive business					
a. Develop a Jobs Creation Credit that is based on employee growth. The tax credit would provide new opportunities for employment and training	5	4	3	2	1
Issue #18 Representation of small business interests					
a. Appoint representatives of the small business community to all policy making, regulatory and advisory bodies of the executive and legislative branches of the federal government	5	4	3	2	1
Issue #19 International trade policy					
a. Federal government must pursue policies that create a more equitable and stable international currency exchange rate	5	4	3	2	1
b. Oppose efforts to restrict free and equal trade opportunities in the world market place, including such protectionist measures as domestic content legislation	5	4	3	2	1
Issue #20 Health care cost containment					
a. Encourage states to enact legislation requiring hospitals and health care providers to charge all patients on the same equitable basis	5	4	3	2	1
b. Forbid cost shifting from one group to another	5	4	3	2	1

	Strongly Favor/ Agree		Indif- ferent		Strongly Oppose/ Disagree
Issue #21 Industrial Revenue Bonds					
a. Preserve and expand small issue IRBs and the pooling of IRBs; base financing restrictions on company/project size rather than state quotas	5	4	3	2	1
Issue #22 Utility rate-making					
a. Require utilities to provide a small business cost-of-service analysis in every rate increase request	5	4	3	2	1
b. Require that utility commissions address issues of competition and adverse effects on small business	5	4	3	2	1
c. Postpone the $6 telephone access charge for businesses with more than one line until a uniform system of charges is adopted for all users	5	4	3	2	1
d. Accord small business equal treatment in rate-base cases	5	4	3	2	1
Issue #23 Unemployment compensation					
a. Do not defer or forgive repayment of federal loans	5	4	3	2	1
b. Prohibit bigger benefits or easier qualifying during periods of lower unemployment	5	4	3	2	1
c. Allow Federal Supplemental Compensation program to expire on 3/31/85	5	4	3	2	1
d. States should take action to control cost increases by improving experience rating and targeting of benefits, rather than raising taxes	5	4	3	2	1
e. The duration of benefits should be minimized to encourage job seeking	5	4	3	2	1
f. Unemployed persons found to be below subsistence after the normal benefit payments terminate, should be transferred into other public assistance programs	5	4	3	2	1
g. The current state-by-state system of unemployment compensation is preferable to federal control	5	4	3	2	1
h. Exempt employers from paying unemployment compensation taxes for employees who are never eligible for benefits, i.e., corporate officers	5	4	3	2	1
Issue #24 Pooling of SBA-guaranteed loans for sale in secondary money markets					
a. Give statutory authority for the sale of loans in the secondary market	5	4	3	2	1
b. Permit pooling of SBA-guaranteed loans	5	4	3	2	1
c. Mandate administrative reforms for greater efficiency in the secondary market	5	4	3	2	1
Issue #25 Small business investment incentive					
a. Permit a qualified small business to raise up to $250,000 for operations and expansion through the sale of stock while allowing individual investors a deduction of up to $15,000 on their tax returns ($30,000 joint) for stock purchased in that small business	5	4	3	2	1

Some facts about your company for demographic profiling.

1. Annual Revenues/Sales are:
   - ☐ Under $1 million
   - ☐ $1 - $10 million
   - ☐ $10 - $50 million
   - ☐ $50 - $100 million
   - ☐ over $100 million
2. Primary activity:
   - ☐ Manufacturing
   - ☐ Wholesale/Retail
   - ☐ Finance/Insurance/Real Estate
   - ☐ Services
   - ☐ Other ______________
3. Form of business is:
   - ☐ Public Corporation
   - ☐ Private Corporation
   - ☐ S Corporation
   - ☐ Partnership
   - ☐ Sole Proprietorship
4. We employ:
   - ☐ 1-19 people
   - ☐ 20-99 people
   - ☐ 100 or more

Fold to show address, staple, stamp, and mail.

Mr. Donald Rappaport
National Director of Smaller Business Services
Price Waterhouse
1801 K Street, N.W.
Washington, D.C. 20006

STATEMENT ON SMALL BUSINESS ISSUES
DELIVERED TO THE SENATE SMALL BUSINESS COMMITTEE

February 6, 1985

by Herbert L. Spira
Office of Federal Tax Services
Arthur Andersen & Co.
Washington, D.C.

Mr. Chairman, Members of the Committee, my name is Herbert Spira, and since 1981 I have been a Tax Manager in the Office of Federal Tax Services of Arthur Andersen & Co. in Washington, D.C. Our firm wishes to appear today to support the efforts of this Committee to sustain a healthy small business community within a growing economy, including appropriate governmental representation at the federal level.

Some history will help to explain our interest in small business enterprises. Our firm was founded in 1913 by Arthur Andersen, a professor of accounting at Northwestern University. We are thus the most recent arrival of the large national accounting firms. In 1944, a Small Business Division was established as a specialized vehicle for the best possible service to the American small business community.

Our Firm's commitment to small business is indicated by 850 partners and managers, all accounting professionals in the audit, tax and management consulting fields who are devoted to serving smaller firms in their regions, cities and towns throughout this country and overseas. Their professional activities are supported by several thousand professional staff members, each with a university degree in a skill area supportive of our practice.

Our small business professionals undergo specially designed training after joining Arthur Andersen & Co. They are assigned to offices on a long-term basis, so that they can become acquainted with entrepreneurs personally, and can be available and responsive to their individual needs. They are rated for advancement purposes on the basis of their service to small business. The Firm also maintains a presence in Washington, D.C. to keep our offices and our clients informed of governmental developments that can affect new, small and growing firms, and I serve in that position.

IMPORTANCE OF SMALL BUSINESS IN THE U.S. ECONOMY

The statistics indicate that small enterprises constitute a very significant segment of the economy. Numerically, approximately 17 million businesses filed tax returns in fiscal year 1981, the last year for which complete information is available. Of these, an estimated 97% or 16 million were small businesses.(1)

In terms of providing employment, the President's most recent report on "The State of Small Business" indicates more than 50% of total private employment is in small firms (1984 Report, page 235.) In job creation, small business is a powerhouse. In 1981 and 1982, for example, smaller firms of less than 100 employees created 2,650,000 new jobs, while all the rest of the economy actually lost 1,664,000 jobs.(2) The share of jobs generated by small business varies with the business cycle, as would be expected, but several analytical studies performed at leading institutions conclude that small firms have consistently generated between 50% and 100% of net new employment during the past 15 years.(3)

Small enterprises are also the source of about half of all industrial innovation in this country, according to many Congressional,(4) governmental(5) and private studies. Business ownership throughout our history opened the door of opportunity to the mainstream of American life.

Our Firm salutes that kind of economic achievement. We are proud to say that we grew up with smaller enterprises, and they are one of the factors that made Arthur Andersen & Co., as of last year, the number one accounting firm in the world.(6) So, we have our own private reasons for urging a favorable climate for small businesses, as well as for large businesses, so both groups make a maximum contribution to the growth, quality, and competitiveness of the U.S. economy.

PUBLIC POLICY SHOULD RECOGNIZE SMALL BUSINESS

However, we believe there are also public reasons for recognizing past contributions of smaller enterprise and fostering more of the same in the future.

In our opinion, an overriding reason is that small business represents one of the nation's prime adaptive mechanisms. That function seems to us vitally important during periods of rapid structural change, such as many observers have concluded that we are now experiencing.(7)

The value of this adaptive resource to our economy has been brought home to us in striking fashion by foreign commentators. At the economic summit conference in London in June, 1984, a U.S. official was quoted by the press as saying:

> "They all, including the French, simply cannot get over it. They cannot understand why we can create all these jobs and they can't."(8)

The statistics, in round numbers, are that the U.S. has increased civilian employment from 87 million in 1974 to about 104 million in 1984, an increase of 17 million jobs over the last decade, while Europe actually lost jobs during that period.[9]

As to innovation, the Economist magazine, in a feature length analysis, concluded that Europe was falling behind the U.S. in developing new technology largely because of two factors: the lack of a true common market and neglect of small entrepreneurial enterprises.(10)

One example of how a new business can adapt to the environment and benefit the economy is the Tandem Corporation. It was founded in 1974 to make complex computer systems. In 1983, this "new" business became Number 500 on the Fortune list of the largest industrial companies, with $418 million in sales, $416 million in assets and 4,396 employees.(11)

New products, often developed by new businesses, become the passports of the U.S. to export markets. These innovations also help American business maintain its share of domestic markets, which are now significantly more internationalized.(12)

During a recent 15-year period, high technology business in the U.S. (where new and small firms made an important contribution) increased its share of the trade balance from +$5 billion to +$25 billion. Low technology industry went from a neutral balance to a minus $16 billion during the same period.(13)

PROPOSALS FOR CHANGE SHOULD BE CAREFULLY EVALUATED

For these reasons, our firm believes that small business should continue to be encouraged in this country, as a matter of federal policy.

We agree that the present rapid pace of economic change makes a case for constant re-evaluation of all of our institutions, to assure that they are cost-efficient. This applies to federal long-term financial assistance to small business. The observations that follow provide information to assist in this evaluation.

On a prior occasion, the U.S. General Accounting Office examined the question of whether the value of the long-term financial assistance program should be measured by the estimate that less than 1-percent of small businesses receive any type of financial assistance from SBA.

The GAO concluded that a "more meaningful assessment is to compare the number of small businesses needing long-term financing...(to what SBA provides in long-term financing)."(14) By this test, GAO, citing Dun and Bradstreet, stated that only about 4.5 million firms had ever applied for credit during their history.(15)

The GAO report then estimated that "approximately 30 to 40 percent of the dollar amounts of banks' long-term financing (6 years or more) to small business may carry an SBA guarantee."(16)

The report also found that the guarantees permit lenders to provide longer term loans and larger loans than small businesses would otherwise receive.

As to length, just over half (52%) of all private business loans are for less than one year, while more than half (59%) of SBA guaranteed loans are for 6-10 years,(17) and another 15% of the SBA guaranteed loans are for more than 10 years. Thus, a total of 74% of SBA guaranteed loans are long-term (6 years or more) compared to 15% of private sector business loans.

As to amount, banks responding to the GAO survey reported that their average private sector business loan was about $58,000, while the average SBA guaranteed loan was $118,000, more than double the private figure.(18)

Further, SBA's annual reports over the years reflect that after SBA repurchases a loan, the business situation can, in some cases, be turned around and the loan made good. If the loan goes as far as liquidation, money can be realized from the sale of collateral. So, if SBA tabulations are reliable, the actual loss rate on Agency's 7(a) guaranteed business loans would appear to be less than 5% (4.95%) through the end of the fiscal year 1983.(19)

This seems remarkable in view of SBA's mission to lend to the newer ~~and riskier~~ businesses that private credit markets would hesitate to fund. The agency's mission is ilustrated by a commentary of the Independent Bankers' Association of America, an asssociation of about 7,400 of the smaller U.S. banks:

> "***the 7(a) program continues to focus on riskier new small business ventures which show real promise for success. As such, the SBA loan guarantee effort remains fully justifiable as a counterbalance to the fact that private credit markets without any guarantee tend to overemphasize the risk of such new small business ventures and to underallocate funds to this type of small business* * *".(20)

LIMITED ROLE OF VENTURE CAPITAL

It is questionable that the venture capital industry would adequately service the segment of the small business community described in the IBAA letter, because as spokesmen for the industry themselves point out: "Venture capitalists are highly selective, choosing only a minute percentage of funding requests they receive. The typical venture firm might review 200 to 300 proposed ventures annually, prepare detailed analysis for 25 or 30 and fund five."(21)

A further element of selectivity is that "a large share of the venture capital investments tend to be in high technology oriented businesses."(22) In fact, in 1981, about 80 percent (80.2%) of all venture capital investments were concentrated in seven industries: communications, computers, electronics, genetics, medical, energy and automation.(23)

QUESTIONS FOR THE COMMITTEE

Whether the needs of our economy for new and productive jobs, innovation, competition and opportunity are any less pressing than they were in the past, and the roles of small business and the Small Business Administration in pursuing these goals, are questions Congress will have to address.

We support the efforts of this Committee, as the duly constituted voice of small business in the U.S. Senate, to carefully consider any proposal for change in small business institutions and to report its expert findings for consideration and action by the Congress. With this hearing, the deliberation has begun and we thank you for allowing us to be part of the process.

NOTES

1. Enterprises filing tax returns for 1981:

Corporations	-	2.8 million
Partnerships	-	1.5 million
Sole Proprietorships	-	12.7 million
	Total	17.0 million

2. See "The State of Small Business: A Report of the President, March, 1984," page 2. Information is on an enterprise basis, disaggregated to the level of independent subsidiaries. For example, Continental Baking is separated from IT&T, so the industry statistics on baking will not be distorted. However, all separate facilities of Continental Baking are aggregated to reach the total for that one firm. See, "A Guide to Understanding U.S. and State Small Jobs Generation Data," U.S. Small Business Administration, December, 1984.

3. Leading Studies of Small Business Job Creation:

Source	Period of Observation	Percentage of Jobs Created by Enterprises with less than 100 employees
MIT	1969-72	82
MIT	1972-74	53
MIT	1974-76	65
Brookings	1976-80	51
MIT	1980-82	100+

See, "The Small Firm Role in Jobs Creation," Paper prepared by the Office of the Chief Counsel for Advocacy, Small Business Administration, June 5, 1984, page 3.

In comparison, the Fortune 500 largest corporations employed 14.8 million people in 1969 and 14.1 million in 1983. See Fortune Magazine, May and June 1970-1983; April 30, 1984, page 275.

4. See Senate Report 1413, "Under-utilization of Small Business in the Nation's R & D Effort," Joint Report of the Senate and House Small Business Committees, 95th Congress, December 28, 1978.

5. See, for example, "Science Indicators, 1976," Report of the National Science Board, National Science Foundation, 1977, pages 116, 118.

6. On an income basis -- others may have more offices.

7. See, for example, "On an Investment Collision Course," by David Hale, *Wall Street Journal*, January 24, 1985, page 30:4; Cut Costly Myths: The Family Farm is Doomed," *Washington Post*, January 20, 1985, page C1.

8. "Jobs Issue Enhances U.S. Clout at Summit," by Hobart Rowan, *Washington Post*, June 11, 1984, page A1.

9. Economic Report of the President, February 1984, Table B-30, page 256; also, according to the Organization for Economic Cooperation and Development, unemployment in the European community rose by more than 10 million since 1973 for a net loss of 1.5 million jobs. See "Machines Blamed in Europe Joblessness," *Wall Street Journal*, November 19, 1984, p 1:5; and "Eurosclerosis," by Hobart Rowan, *Washington Post*, November 22, 1984, op. ed. page.

10. "Europe's Technology Gap," The *Economist*, November 24, 1984, pages 93-98.

11. *Fortune Magazine*, April 30, 1984, *loc. cit*.

12. "The Role of High Technology Industries in Economic Growth," Data Resources, Inc., March 15, 1977; see also "Minding America's Business" by Magazine and Reich, Harcourt, Brace, Jovanovich, 1982. The *Wall Street Journal* estimated that almost 15% of the entire U.S. market for goods was accounted for by imports in 1984, up from 12.7% in 1983 and 6.3% 20 years ago. See "Dollars Rise a Boon for Many, Also Hurts Major U.S. Industries," February 22, 1985, page 1, right lead.

13. "The Rise of High Technology Industries," *loc. cit.*

14. "SBA's 7(a) Loan Guarantee Program: An Assessment of its Role in the Financial Market," GAO Report RCED 83-96, April 25, 1983, page 30.

15. *Ibid*.

16. According to a sample of 8,900 commercial banks, approximately 60% of the nation's total.

17. "SBA's 7(a) Loan Guarantee Program..." *loc. cit*, page 21, table.

18. "SBA's 7(a) Loan Guarantee Program..." *loc. cit*, page 23. The GAO sample was based upon the 8,907 banks that had made SBA loans in 1979-81. The selection was weighted somewhat toward the larger institutions, as follows:

Stratum	Universe	Sample
Assets of under $100 million	7,413	337
Assets of under $100 million to $1 billion	1,320	440
Assets of more than $1 billion	174	174
	8,907	951

19. SBA Annual Reports, also Small Business Administration, Office of the Comptroller, Fiscal Year 1983, loss rates study, page 2.

20. Letter from IBAA to Subcommittee on State, Justice, Commerce, and Judiciary, Senate Committee on Appropriations, February 17, 1982.

21. "Venture Capital" an essay by the National Association of Small Business Investment Companies, contained in "Investing in America, Initiatives for Community and Economic Development," President's Task Force on Private Sector Initiatives, December 1982, page 82.

22. "Venture Capital," loc. cit, pages 85-86.

23. Ibid.

Legislative Solutions
to the
Payment Problems of Subcontractors
on Federal Construction

Statement of

AMERICAN SUBCONTRACTORS ASSOCIATION

to the

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

February 11, 1985

Legislative Solutions to the Payment Problems of Subcontractors on Federal Construction

The American Subcontractors Association (ASA) is a national trade association with more than 5,500 firms representing all major construction trades in 55 chapters. It is the only national organization that speaks exclusively for the interests of construction subcontractors. ASA is dedicated to improving general business conditions for subcontractors through unified and cooperative actions.

In a recent survey of its members, ASA found that the most important issue facing construction subcontractors today is getting paid for work performed. Although concern about the nation's economy and the keen competition in the construction industry ranked high, the overwhelming majority of subcontractors participating in the survey reported that the inability to get paid in a timely manner is their most serious problem.

Subcontractors depend on the cash flow generated by payments on account to meet their payrolls and loan payments and to pay their suppliers. Yet some prime contractors take 90, 120, or more days to pay their bills.

For a big business, such a delay in payment would undoubtedly cause some consternation in the bookkeeping department, but business would go on as usual. For a small firm, the size of most construction subcontractors, however, one payment might mean the difference between survival and disaster.

ASA is attempting to solve the payment problems of subcontractors at all levels - in the private sector by talking to major construction investors and the financial institutions that loan them money; at the state level by seeking improvements to lien and other payment laws; and now at the federal level by asking you to help put the federal government's house in order.

Background

Fifty years ago the general contractor engaged to construct a building performed most of the work with his own forces, hiring craftsmen and tradesmen directly on his payroll for specialized building tasks. A system of payment grew naturally out of this arrangement: the owner paid the general contractor the amount due and the disbursement of funds to other parties, if any, was then the general contractor's responsibility.

Today, most general contractors perform only a small fraction of actual construction. On federal government projects, that percentage is usually less than 20 percent. Instead, work is subcontracted to firms that specialize in particular fields.

Now that subcontractors provide by far the majority of onsite labor and materials, the traditional payment system is creating cash flow problems for those two and three steps down the payment process as those higher on the ladder divert funds for other business or personal uses thus delaying payment to those who actually perform the work.

Further pressure is placed on the system by such factors as:

- General and other prime contractors may inflate the values for the various portions of the work in their requisitions than those represented by the amounts of individual subcontractors or purchase orders for those trades. This practice is often called "front-end loading".

- Project-wide retainage may be reduced by the owner in payments to the general contractor and others having direct contracts. However, those contractors may feel no legal or moral obligation to pass the retainage money along to their subcontractors or suppliers.

- Many subcontract agreements have "pay when paid" provisions. Unscrupulous contractors use these provisions as an excuse for not paying subcontractors' requisitions promptly even in those cases where money was received by the prime contractor. Also, many contractors do not pay subcontractors for work that has been satisfactorily performed when contractors have not been paid for reasons totally unrelated to the subcontractors' performance.

The net result is that construction subcontractors and suppliers are often paid at a slower pace than the rate at which an owner advances funds for a project. In fact, an owner (or his surety) may even have to pay twice for the same work if funds are diverted by a party who becomes insolvent.

The need is clear: modify the system of handling construction payments so that it will (1) protect the owner and lender, (2) speed the flow of funds to those performing the work, and (3) still preserve the ability of the general contractor to control the job.

Federal Construction

Subcontractors' payment problems are perhaps more severe on federal construction projects than on private or other public work perhaps because of the exaggerated extent to which some agencies carry the principle of ignoring the existence of subcontractors in the absence of privity of contract.

Private owners are often quite mindful of the need for payment of subcontractors to assure performance and avoid liens. Thirteen states have laws which designate moneys paid to prime contractors as trust funds and make it a criminal offense for a prime contractor to use the portions of these funds owed to subcontractors for any purpose other than payment of the subcontractors. Fifteen states have other explicit requirements of flow-through.

At the federal level, subcontractors have only two avenues to resolve the lack of payment: (1) a complaint to the contracting officer about the prime contractor's failure to pay after he has certified payment; and (2) a suit against the payment bond required under the Miller Act.

Certification of Payment. Several of the civilian agencies, including the General Services Administration (GSA) and the Veterans Administration (VA) require that a prime contractor "prior to receiving a progress or final payment . . . shall submit to the Contracting Officer a certification that the Contractor has made payment from proceeds of prior payments, or that he will make timely payment from the proceeds of the progress or final payment then due him, to his subcontractors and suppliers in accordance with his contractual arrangements with them."

Although the "Certification of Payment" requirement is a step in the right direction, there is no follow-up to assure its enforcement. Even if a subcontractor complains about lack of payment, the most a contracting officer will usually do is to call the prime contractor and strongly suggest that payment be made. At this point, the prime contractor can, and usually does claim that the "contractual arrangement" with his subcontractors do not require payment at that time. The contracting officer has no way of knowing otherwise.

Even if the contracting officer desires to pursue the problem, he has no effective enforcement mechanism. Although a prime contractor who signed the "certification of payment" and then failed to pay his subcontractors is, in theory, defrauding the government, it is unlikely that the Department of Justice will file suit for the simple reason the government has not suffered a loss.

Finally, it should be noted that even the "certification of payment" protection is not available on Department of Defense jobs.

Miller Act. In lieu of granting lien rights on federal projects, Congress enacted the Miller Act which, in addition to requiring a performance bond to guarantee completion of the project, requires a payment bond. The purpose of the Miller Act payment bond is to protect all persons supplying labor and material on United States government projects where lien rights are unavailable.

The Miller Act has not lived up to the expectations of Congress. It is too costly and time-consuming for the small subcontractor to pursue. Even if the subcontractor decides to file suit, he can only do so within 90 days from the date on which he last performed work. Thus, the subcontractor has no recourse under the Miller Act for periodic progress payments. The resulting delay in payment for months or even years can easily bankrupt a subcontractor.

Legislative Solutions

In light of the ongoing payment problems of subcontractors on federal construction and the failure of federal agencies to find adequate solutions, ASA suggests that the time has come for congressional action.

After careful study, ASA has developed three legislative proposals to remedy subcontractor payment problems. They are:

(1) prompt payment of subcontractors;
(2) criminal penalties for diversion of trust funds; and
(3) amendments to the Miller Act.

Prompt Payment of Subcontractors

In 1982, Congress passed and President Reagan signed the federal Prompt Payment Act. This Act requires federal agencies to pay all bills within 30 days. Agencies failing to pay promptly muft automatically pay interest penalties.

Since the Prompt Payment Act took effect in October 1982, the federal government's payment practices have improved dramatically. For fiscal year 1983, federal agencies paid over 99 percent of their bills on time, compared to 61 percent on time before the Prompt Payment Act.

Despite the example set by the federal government, many prime contractors have not followed suit in their dealings with subcontractors. ASA continues to receive reports from subcontractors who are not being paid for work they have completed on federal construction projects.

Some states which received similar reports have passed amendments to their own prompt payment laws requiring prime contractors on public work to promptly pay their subcontractors or face interest penalties similar to those faced by the state if it fails to pay its bills.

ASA believes that the federal government should follow the lead established by these states and enact similar legislation. ASA has drafted such a bill for your consideration. See Attachment A.

This bill, entitled "Prompt Payment for Government Subcontractors Act," would require that a prime contractor on federal work pay his subcontractors within seven days of his receipt of payment from the federal government or face interest penalties identical to those faced by the federal government under the Prompt Payment Act. It would require the prime contractor to make adjustments, if any, in the subcontractor's pay request at the time of certification.

Although at first this bill may be regarded as an intervention into a contractual relationship between other parties, it should be recognized that the prime contractor is only a conduit for transmittal of payments from the federal government to those who have actually performed the work or supplied the material. The money belongs to the government until it is paid to the prime contractor, and thereafter it belongs to the subcontractor and suppliers, except for that portion earned specifically by the prime contractor. The federal government has every right to be concerned that such payments are made.

ASA believes that seven days is sufficient time for a prime contractor to pay his subcontractors. After all, the only thing the prime contractor has to do is write a check. Everything else was accomplished prior to incorporating the subcontractor's billing into the contractor's billing to the federal government.

If full payment has not been earned by a subcontractor because of poor performance, the prime contractor should not have falsely certified to the completion of such work in his billing to the government. Thus, the government, not the prime contractor, should be holding all unearned payments until they have been earned.

Seven days is the maximum standard for subcontractor payment used in the private sector. The American Institute of Architects (AIA) Document A401, Standard Form of Agreement Between Contractor and Subcontractor (1978 edition), provides for such payments to be made within three days after receipt of payment by the prime contractor. The Associated General Contractors of America (AGC) Document No. 600, Subcontract for Building Construction (August 1984), provides for such payments to subcontractors within seven days after receipt of payment by the prime contractor. So does a recently adopted joint policy statement of AGC, ASA, and the Associated Specialty Contractors (ASC).

Criminal Penalties for Diversion of Trust Funds

As noted above, the failure of contractors on public improvement projects to channel funds received by them through the appropriate payments chain is a serious problem for construction companies doing business with the federal government.

Prime contractors who divert monies from the chain cause great hardship to subcontractors who may be unable to pay suppliers. Subcontractors who misappropriate funds injure both suppliers and primes, the latter often having to pay twice for the same services or materials.

Although civil law permits the recovery of a judgment against the party misusing the funds, it is of little consolation when obtained against an insolvent or bankrupt firm or individual.

As a result, the sureties who stand behind both the primes and the subcontractors, suffer financial damage. And, in the long run, the taxpayers end up paying the tab when public monies are improperly diverted or misappropriated from publicly funded projects.

In order to combat such flagrant abuses, some state legislatures have determined that it is a crime to divert funds disbursed for a construction project for self-serving use. A few states, such as New York and Wisconsin, have statutes that impose a fiduciary responsibility upon the recipients of construction funds. Under such legislation, funds are paid to an owner or contractor with the implied understanding that they are to be maintained in trust until deserving parties are repaid. Only the leftover funds, or profit from the contract, may be diverted for use elsewhere. The criminal sanctions contained in these laws have made them virtually self-enforcing.

ASA is convinced that "trust fund" provisions have served well in several states to discourage diversion of funds, decrease owner vulnerability to liens and encourage the liberal extension of credit by subcontractors and suppliers. Such a provision benefits lenders, owners, construction firms, and suppliers.

The trust fund concept is also often used in the private sector. For example, the AIA Document A201, "General Conditions of the Contract for Construction (1976 edition), often called "the Bible" of the construction industry, requires the prime contractor to promptly payeach "Subcontractor, upon receipt of payment from the owner, out of the amount paid to the Contractor on account of such Subcontractor's Work, the amount to which said Subcontractor is entitled." The A201 also requires the prime contractor to, "by an appropriate agreement with each Subcontractor, require each Subcontractor to make payments to his Subcontractors in similar manner."

In addition, the AGC Document No. 600, Subcontract for Building Construction, recognizes the trust fund nature of relations between subcontractors and sub-subcontractors and suppliers by requiring that "No payment received by the Subcontractor shall be used to satisfy or secure any indebtedness other than one owed by the Subcontractor to a person furnishing labor or materials for use in performing the Subcontractor's Work."

ASA believes that the trust fund concept lends itself naturally to adoption at the federal level. Again, it should be recognized that the prime contractor, and often the subcontractor, is only a conduit for transmittal of payments from the federal government to those who have actually performed the work or supplied the material. The federal government has every right to be concerned that such payments are made on federal construction.

ASA has drafted a trust fund proposal for your consideration. See Attachment B.

This bill would provide that funds received by prime contractors and subcontractors as payment for work performed under contracts for the construction, alteration, or repair of any public building or public work of the United States constitutes trust funds. It also would provide a criminal penalty - a fine of up to $15,000, imprisonment up to 10 years or both unless the amount "stolen" is under $100 in which case the fine would be limited to a maximum of $1000 and imprisonment of not more than one year or both - for the use of such funds contrary to the trust.

Such a strong law should be available as a deterrent to the small percentage of firms or individuals who deliberately appropriate other people's funds, realizing there is little consequence with which to be concerned. Where the consequences may include a criminal record or even incarceration, a different result obtains.

Adoption of the trust fund concept on a national level will produce immense benefits for all concerned. It will protect prime contractors from failing or unscrupulous subcontractors who would otherwise be tempted to divert or misappropriate funds received by them to non-project purposes. It will protect subcontractors from primes who are tempted to do the same. It will protect suppliers from misappropriation by either or both. It will protect sureties who stand behind the obligations of all. And, finally, it will protect American taxpayers by assuring that public funds will be used solely for the purposes for which they were authorized and obligated.

ASA asks the Congress to seriously consider this proposal.

Amendments to the Miller Act

The Miller Act was enacted in 1935 to provide protection to persons furnishing materials or labor to prime contractors on federal construction. It provides for a performance bond protecting and government and a payment bond for the protection of the subcontractor or supplier. At time of enactment and later amendment, it was considered good legislation and, up to a point, it has been. However, it has fallen short in many areas.

As noted above, construction subcontractors are very typical of American small business. They lay out large sums for materials prior to the start of work. They must promptly pay their labor as required by law. Thus, they do not have large capital reserves that would permit long, unexpected, and unnecessary delays in being paid in full within a reasonable time.

Yet many subcontractors on federal work have been forced to operate on borrowed capital, sometimes paying a high rate of interest, while waiting to collect fully on work completed and accepted. Others have been financially ruined.

Thus, regardless of what Congress may have intended, the protection afforded by the Miller Act, as it now stands, is a snare and a delusion. Any subcontractor who has ever had experience with a suit on a Miller Act bond, will resort to it only where the prime contractor has been adjudicated bankrupt, or is otherwise hopelessly insolvent.

ASA believes that the Miller Act must be amended in several areas if it is to once again live up to the expectations of Congress - and most importantly, protect the subcontractor and supplier on federal construction projects.

Attorneys' Fees and Interest. Many assume that a prime contractor or his surety settles payment claims upon receipt of notice and after investigation of the merits and validity of the claim. However, ASA receives many complaints from unpaid subcontractors that a surety's disclaimer, failure to respond, or other act had demonstrated that it would be necessary to resort to actual court action in order to secure the satisfaction of the claim.

In some cases, the claimant is reluctant to initiate litigation because it is clear that the litigation costs would be so high in proportion to the amount that would be recovered as to constitute an effective legal barrier standing in the way of utilization of the very protection which Congress has statutorily prescribed.

Thus, the bonding requirement has operated unevenly and unfairly. For large firms which take on sizable subcontracts and whose claims may be sufficiently large to permit litigation, the bonds offers the protection intended.

For those whose claims are small, and who most often are very small firms, the protection is not available from a practical standpoint.

ASA believes that an amendment to the Miller Act that would permit an unpaid subcontractor whose claim is valid and who can litigate successfully, to recover interest and the reasonable cost of legal fees, would correct this inequity.

Prohibit Waiver of Rights. Some agreements between a prime contractor and subcontractor require the subcontractor to waive, directly or indirectly, his rights under the Miller Act.

For example, many subcontracts contain a "pay when paid" clause which allow the prime contractor to delay paying his subcontractors until he has first been paid by the owner. Thus, a subcontractor, whose work may be completed during the first few months of a two or three-year project, may have his final payment delayed for several years beyond his completion date. If the subcontractor asks for final payment before final completion of the project, the prime contractor can point out that the government (despite OFPP Policy Letter 83-1) has withheld retainage for a portion of the subcontractor's work and that the money is not due to the subcontractor until the prime is paid full retainage by the government - perhaps several years after the subcontractor completes his work. If the subcontractor does wait, without consulting an attorney, he will lose all rights he has under the Miller Act, because the Act requires that suit be instituted on the bond not later than one year after the subcontractor has last furnished materials or services for the project. If he consults his lawyer, his lawyer will advise him that he must file suit within one year, but if he does sue, the prime contractor and the bonding company will defend on the grounds that the money is not yet due.

Still another example, many construction subcontracts contain provisions requiring that parties submit their claims to arbitration. However, the presence of an arbitration provision does not operate to suspend the one year limitation of the Miller Act. Thus, if the subcontractor waits until arbitration is completed to file suit, he may lose his rights under the Miller Act.

Such subcontract provisions are often designed to protect the prime contractor and his surety by providing them with defenses on a bonded job. Such provisions obviously operate to the legal and practical detriment of the subcontractors and are against public policy.

Individual subcontractors are in a poor bargaining position to refuse to sign subcontracts containing such onerous provisions. In fact, many subcontractors may not even realize they are waiving their Miller Act rights in the fine print. Again, it would most often be small business firms which do not ordinarily retain an attorneys' services that would most often be victimized by the inclusion of such provisions in their subcontracts.

ASA believes that it should be public policy that no prime contractor may extract from his subcontractors and suppliers any agreement having the effect of waiving any of the rights granted by the Miller Act. ASA also believes it should be public policy that no provision of a contract for the settlement of a dispute, such as an arbitration clause, may be employed to defeat the statutory right of a subcontractor or supplier under the Miller Act to have his claim against a prime contractor adjudicated by the court.

ASA recommends that the Miller Act be amended to nullify any contract provision that would directly or indirectly waive a subcontractor's rights under the Miller Act.

Coverage of Progress Payments. The Miller Act requires certain subcontractors and suppliers to provide written notice to the prime contractor within 90 days from the date on which he performed the last labor or supplied the last of the material for which his claim is made. Thus, such a subcontractor has no rights under the Miller Act to assure the receipt of periodic progress payments, which are usually made monthly on construction projects.

A subcontractor who does not receive a progress payment is put in the untenable position of continuing to work without payment or pulling off a job and possibly halting all construction in order to begin the 90 day period.

ASA thus recommends that the Miller Act be amended to extend coverage to progress payments which are more than 30 days overdue.

Prohibit "Premature Notice". As noted above, the Miller Act requires certain subcontractors and suppliers to provide written notice to the prime contractor within 90 days from the date on which he performed the last labor or supplied the last of the material for which his claim is made. Some courts have ruled that notice given before the actual final day of work was premature and therefore dismissed the suit.

Such a situation could arise, for example, where a subcontractor pulls off a job and files suit but then returns to finish his work (most likely at the request of the government).

ASA believes these court rulings provide the prime contractor and his surety with an unfair defense to an otherwise recoverable Miller Act suit, and thus recommends that the Miller Act be amended to prohibit the dismissal of complaints filed prior to the 90th day after the last labor was performed or material supplied.

Certified Mail. The Miller Act requires that the 90 day notice be by "registered" mail. Although most courts have excused this requirement when it is shown that a prime contractor actually received notice, it still may provide the surety with an unfair defense to an otherwise recoverable Miller Act suit. ASA recommends that the Miller Act be amended to allow notices to be sent by certified as well as by registered mail.

Health and Welfare and Other Benefits. The Miller Act provides for a right of action upon the prime contractor's payment bond by "any person having direct contractual relationship with a subcontractor." In 1978, the Supreme Court narrowly construed the Miller Act language by holding that the employees of a sub-subcontractor could not claim against the prime contractor's payment bond. The sub-subcontractor had defaulted in certain payments to its union employees. The rationale was that the employees of a sub-subcontractor lacked the necessary direct contractual relationship with the subcontractor. However, the sub-subcontractor would be protected by the prime contractor's payment bond if the subcontractor defaulted in its obligations to the sub-subcontractor.

Thus, ASA recommends that the Miller Act be amended to extend coverage to health and welfare and other benefits for labor furnished to an eligible subcontractor.

100% Payment Bond. The Miller Act requires government prime contractors to furnish the government both performance and payment bonds for the protection of the government and subcontractors, respectively. The United States government is protected by a 100% performance bond. The subcontractors are protected by a payment bond which is currently for one-half of the contract amount if the contract is for less than $1 million; 40% of the contract amount if the contract amount is between $1 million and $5 million; and a $2.5 million maximum if the contract is for more than $5 million.

The maximum dollar protection for a subcontractor under the Miller Act payment bond has been severely eroded by inflation. In any event, ASA believes that the subcontractors on government construction deserve the same protection as the government is now granted under the Miller Act.

Thus, ASA recommends that the Miller Act be amended to provide a 100% payment bond for the protection of subcontractors and those in a direct contractual relationship with subcontractors.

Affirmative Obligation on the Government. Again, the Miller Act requires government prime contractors to furnish the government both performance and payment bonds for the protection of the government and subcontractors, respectively.

In the event that a Miller Act bonds has not been posted by the prime contractor, than the contract is voidable and can be terminated by the government at its option. If the government does not terminate the contract, but allows the prime contractor to perform the contract without furnishing a bond and the prime contractor is unable to or fails to pay the claimant, the claimant obviously has no recourse against a surety. Furthermore, the overwhelming weight of authority holds that such a claimant has no standing to sue the government for any retained funds since it is not in privity with the government.

Essentially, the courts have ruled that the Miller Act places no affirmative obligation on the government because "it says absolutely nothing about what happens when the contractor fails to furnish the bond." The statute only requires that contractors obtain performance and payment bonds. While the courts have admitted that the statute makes no provision for the situation in which both the contractor and the government ignores the bonding requirement, they have concluded they have no power to fill in this loophole, especially in view of the very narrow remedy actually granted under the Miller Act.

ASA believes it is wrong - and an abrogation of congressional intent - for a subcontractor to suffer a financial loss because of the government's failure to enforce the Miller Act.

Therefore, ASA recommends that the Miller Act be amended to place an affirmative obligation on the government to assure prime contractor compliance with the Miller Act.

ASA is in the process of preparing legislation that would address each of the above recommended amendments to the Miller Act. We will submit this legislation for your consideration as soon as it is completed.

Summary

Subcontractors on federal construction often have severe problems when trying to collect payment for completed work. In light of these ongoing problems and the failure of federal agencies to find adequate solutions, ASA believes that time has come for congressional action.

After careful study, ASA has developed three legislative proposals to remedy subcontractor payment problems on federal construction. They are:

(1) prompt payment for subcontractors;

(2) criminal penalties for diversion of trust funds; and

(3) amendments to the Miller Act.

Although each of these legislation proposals stands alone, ASA believes that passage of all three is necessary to remedy subcontractor payment problems on federal construction.

ASA asks Congress to seriously consider and pass appropriate legislation as quickly as possible. ASA's members and resources are available to help in whatever way is necessary to expedite such legislation.

1st Session

A BILL

To require prime contractors to pay interest on overdue payments to their subcontractors on contracts with federal agencies.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Prompt Payment of Government Subcontractors Act."

INTEREST PENALTIES ON LATE PAYMENTS

SEC. 2(a). Any prime contractor who acquires property or services from a subcontractor for the purpose of fulfilling a contract with a Federal agency but who does not make payment to the subcontractor for such property or service within seven days of receipt of payment from the agency shall pay an interest penalty to such subcontractor in accordance with this section on the amount of the payment which is due.

(b) Interest penalties on amounts due to a subcontractor under this Act shall be paid to the subcontractor for the period beginning on the day after the required payment date and ending on the date on which payment of the amount due is made.

(c) Interest shall be computed at the rate determined by the Secretary of the Treasury for interest payments under section 12 of the Contract Disputes Act of 1978 (41 U.S.C. 611). The Secretary of the Treasury shall publish each each such rate in the Federal Register.

(d) Any amount of an interest penalty which remains unpaid at the end of any thirty day period shall be added to the principle amount of the debt and thereafter interest penalties shall accrue on such added amount.

(e) Nothing in this section shall prevent a prime contractor, at the time of application for payment and certification to the cognizant Federal agency, from withholding

(i) payment to the subcontractor for any of the following reasons attributable to the subcontractor's performance:

(1) unsatisfactory job progress;

(2) defective work;

(3) disputed work;

(4) third party claims, filed or reasonably expected to be filed;

(5) failure to make timely payments for labor, equipment or materials;

(6) damages suffered by the prime or another subcontractor;

(7) reasonable expectation that the subcontractor's work cannot be completed for the unpaid balance of the contract price as from time to time amended; or

(ii) a reasonable amount of retainage, provided, however, that in no event shall the percentage of retainage withheld from the subcontractor exceed the percentage of retainage withheld by the Federal agency from the prime contractor.

(f) In no case shall an obligation to pay such interest penalties be construed to be an obligation of the United States.

(g) "Subcontractor," as used herein, means any supplier, vendor or firm that furnishes supplies or services to or for a prime contractor.

EFFECTIVE DATE

SEC. 3. This Act applies to the acquisition of property or services on or after the beginning of the first calendar quarter which begins more than ninety days after the date of enactment of this Act.

1st Session

A BILL

To provide that funds received by contractors and subcontractors as payment for work performed under contracts for the construction, alteration, or repair of any public building or public work of the United States constitute trust funds, and to provide a penalty for the use of such funds contrary to the trust.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. That all monies paid or owing directly or indirectly to any contractor, subcontractor, or material supplier by the federal government for construction, alteration, or repair of any public building or public work of the United States, constitute a trust fund in the hands of the prime contractor or subcontractor to the extent such monies are for labor or materials used for such improvement, until all claims for such monies have been paid, but shall not be a trust in the hands of any person not a prime contractor or subcontractor who receives them in the ordinary course of business without knowledge of their trust nature. The use of such monies by any prime contractor or subcontractor for any other purpose until all claims have been paid in full or pro rata in the case of a deficiency, is theft and shall be punished under 18 U.S.C. §641.

SEC. 2. If the prime contractor or subcontractor is a corporation, such use shall also be deemed theft by any officer, director, or agency of the corporation who is responsible therefor.

SEC. 3. Until all claims have been paid in full, such monies and the right thereto shall not be subject to garnishments, execution, levy or attachments, and shall not be subject to any security interest in accounts receivable or general intangibles given by any prime contractor or subcontractor.

SEC. 4. Every person on whom a trust may be imposed by this section shall keep and maintain adequate books and records sufficient to segregate and identify trust funds received on each specific contract, including a record showing the allocation to each trust of the deposits therein and withdrawals therefrom. Failure of the trustee to keep the books or records required by this section shall be presumptive evidence that the trustee has used or consented to the use of trust funds actually received by him in the form of money or an instrument for the payment of money, for purpose other than the purpose of the trust as specified in Section 1.

SEC. 5. Proof that funds paid to a prime contractor or subcontractor were trust funds as herein provided shall place a burden on such prime contractor or subcontractor or any successor to establish that any disbursements of the funds were consistent with the trust obligation.

NSBGCA
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LEGISLATIVE PRIORITIES

PRESENTED TO:

UNITED STATES SENATE
COMMITTEE ON SMALL BUSINESS
99th CONGRESS
1st SESSION
FEBRUARY 6, 1985

Prepared by:
Lydia Barbara Bashwiner, Esq.
Executive Director

Thank you for providing the National Small Business Government Contractors Association (NSBGCA) with the opportunity to present our legislative priorities to the U. S. Senate Committee on Small Business.

NSBGCA is a trade association representing the interests of small businesses across the country engaged in federal government contracting. Our members supply the U.S. Government, primarily the Department of Defense, with the supplies and services it requires. A large portion of our membership supplies spare parts to the military services and the Defense Logistics Agency.

As such, we were pleased to see the passage of three important pieces of legislation(1) during the second session of the 98th Congress. NSBGCA supplied comments and helped draft each of these bills and is gratified to see our suggestions to improve small business participation in federal procurement process become law, particularly in the face of strong opposition by the Department of Defense.

However, while we applaud the efforts of the 98th Congress regarding small business and procurement reform, we are not content to rest on our laurels and proclaim that every problem small businesses face in selling to the government has been solved. There are still areas which should be addressed and those are listed below. Additionally, vigorous oversight by this Committee and others is essential to insure that Congressional intent is not thwarted in regulations promulgated to implement these laws.

I. Full and Open Competition in Federal Procurement

Full and open competition, recognized by Congress for many years as the preferred method of acquisition, has been reaffirmed and strengthened by the enactment of several new laws in 1984 including the Competition in Contracting Act, the Defense Procurement Reform Act and the Small Business and Federal Procurement Competition Enhancement Act of 1984. It remains to be seen, however, how well the intent of these laws will be followed in implementing regulations yet to be promulgated. These laws should be interpreted so as not to reduce or limit small business preference programs in federal procurement. The implementation process should be closely monitored to insure that small business preferences are protected. New legislation should be introduced as necessary to correct deficiencies or to address other problems.

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(1) P.L.98-525, the DoD Authorization Act of 1985,
P.L.98-369, containing the Competition in Contracting Act,
and P.L.98-577, the Small Business and Federal Procurement Competition Enhancement Act of 1984.

One area of particular concern involves the public posting of solicitations by procuring agencies. Section 4(b)(1)(D) of S.2489 would have required each Federal Agency to "publicly post in either full text or abstract format any solicitation which would have been synopsized in the Commerce Business Daily if it had equalled or exceeded the applicable dollar threshold for such publication...." This provision is not included in P.L.98-577, although NSBGCA supported it in hearings before the Senate Small Business Committee on S.2489.(2) To reiterate NSBGCA's position, there are basically two methods that a small business has of learning about procurements. One is publication in the Commerce Business Daily and the second is by means of the bid board, whereby the procurement centers post solicitations pertaining to requirements. Commonly, private bidding services daily examine the bid boards and synopsize their contents for businesses which subscribe to their service. Depending upon arrangements between the bidding service and the customer, the business either obtains a copy of the solicitation on its own or the bid service obtains it for him. Obviously, if the requirement is not publicly posted, the business may not be aware of the pending procurement and thus is precluded from participating in the bidding process.

There is currently a provision in the FAR which requires contracting officers to disseminate information on proposed contracts in amounts over $5,000 for civilian agencies and $10,000 for defense agencies by (1) synopsizing in the Commerce Business Daily and (2) publicly displaying a copy of each solicitation on bulletin boards in the contracting office. (3) It has been the experience of NSBGCA members that many defense agencies have been ignoring this requirement and are posting very few copies of solicitations. NSBGCA also feels that the $10,000 threshold for defense agencies is too high and that solicitations for contracts over $2,500 should be publicly posted. Further, it has been the experience of NSBGCA members that many synopses of proposed procurements, even above the $10,000 threshold, are not only not being posted but are also not appearing in the Commerce Business Daily. Therefore, unless the small business is directly solicited by the agency, it will not be aware of a proposed procurement and consequently will be unable to bid.

NSBGCA supports the public posting of solicitations. We feel legislation is in order since many agencies are ignoring the requirements stated in the FAR. This legislation should mandate the posting of solicitations over $2,500 as well as the posting of all unclassified selected source or sole source requirements.

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(2) S.Hrg.98-1166, April 6 and 12, 1984, p. 471-2.
(3) FAR 5.101 (a).

II. Simplification of the Procurement Process

The procurement process remains a complex and convoluted process, especially in procurements below the small purchase thresholds. While the small business community has achieved substantial gains in ensuring greater access to government procurement efforts, it remains difficult for the individual firm to participate in the process. The paperwork burden alone is enormous. For FY 1983, the Department of Defense estimated there would be 600,000 business responses to its requests for proposals, requiring 330 million burden hours and costing these businesses $13.2 billion to prepare responses. As many regulatory costs do not vary with the size of the contract, large firms can spread the costs of participation over contracts that are, on the average, five times as large.

NSBGCA suggests that this Committee should concentrate on simplifying the procurement process, particularly with regard to procurements below the small purchase threshold. Legislation should be enacted or administrative initiatives undertaken to enable small firms to participate in the process.

III. Suspension and Debarment of Government Contractors

NSBGCA is concerned about practices in which the Department of Defense has engaged regarding the suspension and debarment of contractors accused of defrauding the government or other violations of either their contracts or federal laws.

DoD has been publicizing its efforts to "crack down" on those accused of cheating on their contracts with DoD. Secretary of Defense Caspar W. Weinberger cited the following statistics as evidence of DoD's "get tough" policy: 657 fraud convictions in FY 1983, with $14 million in fines, restitutions and recoveries made to the government (double the previous year's number of convictions) and 323 contractors last year were suspended or debarred from doing business with the government as a result of audit investigations by DoD, representing an 80% increase over the previous year. In the coming year, we can expect to see more of the same. What concerns NSBGCA is the disproportionate numbers of small businesses being singled out for investigation and prosecution, while many large businesses proceed untouched. Additionally, the forms of punishment for those found "guilty" (with the debarring official usually acting as the prosecutor, judge, and jury) are also much harsher when a small business is involved than a large business.

For example, Rep. John D. Dingell, in a letter dated November 16, 1984, to Navy Secretary John Lehman, expressed concern about the situation wherein General Dynamics Electric Boat Division had provided gifts and gratuities to Admiral Hyman Rickover, USN (Ret.). In that letter, Rep. Dingell noted that he "was surprised to learn that the gratuities clauses have been in shipbuilding contracts for 32 years and have never been enforced against a major contractor of the Navy." (Emphasis in original). On the other hand, he noted, there are numerous examples of DoD and the military services taking aggressive and timely action against small contractors for gratuities that would pale in the face of General Dynamics' behavior in this matter. He cited the instance where one small contractor in Texas allegedly provided a $200 television set to a government employee along with an annual subscription to Playboy . This small contractor was, in short order, debarred from further government business for three years (the maximum time generally permitted under FAR 9.406-4) and a grand jury is currently investigating the contractor's actions. That contractor was never granted a hearing on the matter nor given the opportunity to confront its accusers. Rep. Dingell questions whether "General Dynamics (is) somehow worthy of different treatment." Secretary Lehman has steadfastly refused to terminate the General Dynamics' contracts (production of the SSN688 and TRIDENT submarines) or take any other action against General Dynamics.

It is becoming apparent that DoD has two different sets of rules under which it operates to punish businesses accused of improper or illegal conduct: one for large business and the other for small. Frequently, a small business which is under investigation for allegedly illegal acts is not permitted to receive any contracts pending the outcome of the investigation, which may take many months. For a small business heavily engaged in defense contracting, that type of action may well put the small firm out of business even if the contractor is ultimately cleared of any wrongdoing. Agency actions that effectively exclude a contractor from government contracts without the notice and hearing required by the FAR for debarment may constitute an impermissable *de facto* debarment. For example, publication of names of contractors as ineligible for award is a sanction tantamount to debarment, and, thus, improper unless a debarment hearing has been held. (4)

Similarly, the basis for a non-responsibility determination cannot be used as the basis for non-responsibility determinations in subsequent procurements without invoking debarment procedures.(5)

NSBGCA is concerned first, that DoD's enforcement efforts are disproportionately aimed at small business, and second, that the penalties imposed are more severe against small businesses (debarment) than against large businesses. The reason is obvious if you consider the available resources. Large businesses have greater resources to fight government allegations of wrongdoing and can tie the government up in knots before a final resolution of the issue. On the other hand, small businesses do not have vast amounts of capital necessary to fight the government, especially if they have been cut off from receiving government contracts. Consequently, the government is more "successful" in proceedings against small business.

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(4) *Myers & Myers, Inc. v. U.S. Postal Service et al.*, 527 F.2d 1252 (2d Cir. 1975).

(5) Comp. Gen. B-151269 (Aug. 8, 1963).

NSBGCA feels that legislation is necessary in this area to standardize the procedures regarding debarment so that small business is not selectively prosecuted or inequitably penalized for alleged acts of wrongdoing. Of course, NSBGCA does not condone illegal or unethical conduct on the part of any business, regardless of size, which sells to the government. However, we suggest that this Committee hold hearings to investigage DoD's practices regarding actions it takes or fails to take against businesses under investigation for violations of their contracts and/or federal laws.

IV. Accountability of Contracting Officers

Although this problem affects all businesses, regardless of size, which sell to the government, small businesses are particularly affected by contracting officers and other government employees who refuse to abide by the laws, regulations and procedures regarding procurement. NSBGCA members are continually frustrated by their inability to verify that government employees, and contracting officers in particular, follow enunciated policy. It is at this level, the implementation level, that Congress' efforts to reform the procurement process are thwarted.

Short of engaging legal counsel and instituting suit in an attempt to require the contracting officer to abide by the rules, (an expensive undertaking beyond the financial capability of most small businesses) a small business is without recourse. It has been the experience of most NSBGCA members who have made formal protests to GAO that the action of the contracting officer is usually sustained, which is evidenced by the low percentage of successful protests.(6) Therefore, the bid protest route, from the small business perspective, is usually a waste of time in these cases.

What NSBGCA members would like to see is some mechanism holding contracting officers and other government employees accountable for their decisions. While we appreciate the fact that many contracting officers claim they are overworked, the laws, regulations and policy directives exist to provide a framework within which the contracting officer must carry out his or her duties.

NSBGCA suggests that this Committee hold hearings to investigate this problem. The day to day implementation of the laws and regulations by government employees is where the procurement process breaks down. Although Congress has been criticized for its attempts to "micro-manage" procurement, perhaps it should take another look at this process on the implementation level. Some of the legislation enacted during the second session of the 98th Congress attempts to reach down to the level we are talking about to achieve the goal of full, open and fair competition. However, NSBGCA maintains these laws do not address the accountability of government employees, contracting officers in particular.

Thank you again for the opportunity to present NSBGCA's legislative priorities to this Committee. Once again, we congratulate Congress on its past efforts to ensure that small businesses have more opportunities to participate in the federal procurement process, and look forward to new legislation and vigorous oversight in the coming session.

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(6) For FY 1983, GAO resolved 2,425 protests, upholding only 62 of them or 2.6%. It also took an average of 43 days to resolve a protest.

ASTA
American Society of Travel Agents, Inc.

John C. Bennison
Staff Vice President,
Government Affairs

February 13, 1985

Ms. Tracy Crowley
Senate Small Business Committee
428A Russell Senate Office Building
Washington, D.C. 20510

Dear Tracy:

One issue that is of extreme concern to the travel and tourism industry, and travel agents in particular, is the effort underway by several federal banks to get into the travel field. This is evidenced by the recent Federal Deposit Insurance Corporation's (FDIC) proposed rulemaking and certain provisions under discussion in the banking deregulation legislation currently before the 99th Congress.

The Federal Reserve Board announced that the activities of a travel agency are not "closely related to banking" within the meaning of the Bank Holding Company Act (12 U.S.C. 1843 (c) (8)). Furthermore, the Court of Appeals for the Seventh Circuit upheld the Federal Reserve Board's ruling that bank holding companies could not establish or acquire travel agencies as nonbank subsidiaries.

In view of these legal developments, we believe that the continued operation of a travel agency by a national bank is inappropriate and may expose the bank to a substantial risk of costly litigation.

As you know, the average travel agency employs five people with sales of approximately $1.2 million a year with an average commission rate of 10 percent earned on those sales. Needless to say, travel agents are classic small business operations. Consequently, for us to compete with any bank would put us at an extremely uncompetitive disadvantage. Because of this, we are closely monitoring developments in this area through changes in banking regulations.

I am enclosing a copy of the recent comments we submitted to the proposed rulemaking of the FDIC. It is our hope that the Senate Small Business Committee will also monitor this issue and perhaps take a position in opposing banks being permitted to enter into the travel agency business.

Sincerely,

John

John C. Bennison

JCB/lgg
Enclosure

PROPOSED FDIC RULES COULD HARM U.S. TRAVEL CONSUMER AND TRAVEL INDUSTRY: WHAT SHOULD BE DONE TO BLOCK THE PENDING REVISION OF 12 C.F.R. PART 332

FACT SHEET

I. BACKGROUND AND SUMMARY

The Federal Deposit Insurance Corporation ("FDIC") has tentatively decided to adopt rules which, if finally approved could strongly encourage virtually all banks in the United States to enter and operate retail and wholesale travel companies, as well as various other types of non-banking businesses. These rules, which could take effect as early as April 1985 if adopted, seek to regulate, and therefore legalize as well as provide insurance coverage for an activity already defined as an illegal and unacceptable banking practice by federal courts, Congress and other federal bank regulatory agencies. Furthermore, one federal court has found that *bona fide* travel companies could be severely harmed by banks engaging in the travel business and determined that this result is clearly prohibited by federal banking laws.

The new rules, which attempt to define guidelines for the entry of banks into the travel business, in fact prescribe standards for personnel and travel sales activities which are at best confusing, generally in conflict with one another around the country, and at worst nonexistent. Despite purported safeguards in the proposed rules, their adoption potentially subjects the travel public, the travel industry and even banks themselves to virtually unlimited consumer and commercial abuse. Nothing has changed the rationale underlying all prior legal prohibitions against bank travel business ownership, management or direct marketing activities, namely that banks should not engage in conduct which both requires a type of professional expertise and a level of consumer service not customarily found in banks, just as legitimate travel companies should not engage in banking activities which require special professional expertise to serve the banking consumer.

Although federal regulations currently bar national banks from entering the travel business, there is increasing pressure to change them. The proposed FDIC rules, while they would not directly authorize such conduct, in fact reflect a federal agency position that activities which have been outlawed for years are now acceptable under certain conditions. The FDIC may nonetheless adopt these rules anyway unless it receives sufficient evidence of opposition in the form of written comments from those most likely to be seriously injured by them, namely the travel industry and travel consumer. When the FDIC initially proposed these rules in 1983, it received only a literal handful of comments and deemed this lack of response as travel industry support or apathy for adoption of the rules now proposed. Silence by the industry in this case could guarantee their final adoption, triggering costly litigation and posing a serious threat to the travel public and industry. Travel businesses concerned about avoiding such a result should write, and request each of their employees as well as their clients and supplies, to write the FDIC expressing their views. Opposition comments, which may be in brief, simple letter or mailgram form, must be received by the FDIC on or before February 11, 1985, at the following address:

Hoyle L. Robinson
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Sample comment letters are attached to this Fact Sheet as examples.

II. REASONS TO OPPOSE THE PROPOSED FDIC RULES

1. Federal encouragement and support of illegal banking activities

- Congress, courts and other bank regulatory agencies have already determined that banks belong in the banking business and should not engage in commercial activities for which they neither were created nor are qualified.

- An elected Congress responsive and accountable to the voting public rather than an administrative agency responsive and accountable only to itself should make the laws which govern the American banking system and define bank powers.

2. Reliance upon confusing, conflicting or nonexistent standards to regulate activity requiring uniform rules.

- The proposed rules tie travel personnel and marketing activity standards to both federal law, which is virtually nonexistent since the Civil Aeronautics Board Competitive Marketing decision became effective January 1, 1985; or to state laws, which are either nonexistent or differ substantially from state to state. The sale of national and international travel in the United States must be governed by one set of uniform professional and personnel standards.

- The FDIC rules, if adopted and interpreted in their broadest form, could permit anyone, regardless of qualification, to sell travel to the public in at least some states.

3. Consumer Confusion

   - Both the banking and travel industries currently face tremendous uncertainties because of the chaos and confusion caused by deregulation. This is no time to compound the problem by encouraging the entry of banks, already hard-pressed to meet basic consumer banking needs efficiently, into areas where they lack experience and expertise.

   - Federal banks are governed by federal law, which currently bars federally chartered banks from owning or operating travel businesses and currently provide few if any standards for the sale of travel; while state banks are governed by the laws of 50 states, which differ substantially among one another in the scope of permissible travel sale activities and standards. The travel consumer deserves uniform levels of professional service from whoever provides it, governed by one national set of laws.

4. Extension of federal deposit insurance to unlawful banking activities

   - The entry of federally chartered banks into the travel business has been found an illegal banking activity. The FDIC should not encourage such conduct by seeking to insure it at taxpayer expense.

5. Encouragement of bank entry into all types of businesses unrelated to the public's banking needs.

   - The FDIC rules also encourage extensive entry by banks into the real estate, securities and computer industries. Banks could eventually decide to enter, own and operate all types of businesses with such encouragement, eliminating thousands of small, independent businesses in the process.

6. Competitive Abuse

   - One federal court has already recognized that entry into the travel business could seriously harm bona fide travel companies, a result rejected by Congress.

   - Banks which own and operate travel companies can hardly be objective in making bona fide travel company (as well as company, client) loan and credit decisions.

(Example 2)

SAMPLE COMMENT LETTER

Hoyle L. Robinson
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20424

Dear Mr. Robinson:

I am writing in strong opposition of the proposed FDIC rules to amend 12 C.F.R. Part 332, which would encourage banks to engage in business activities for which they are neither suited nor qualified. As a member of the public and the business community, I do not believe my bank should be distracted from its most important role, namely providing the basic financial services needed in my community. As a depositor, I am concerned about any rule which would increase the risk of loss to my deposits by such distractions.

I urge the FDIC to reject adoption of the proposed new rules.

Sincerely,

(Example 3)

SAMPLE COMMENT LETTER

Hoyle L. Robinson
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20424

Dear Mr. Robinson:

I strongly urge the FDIC not to adopt the proposed amendments to 12 C.F.R. Part 332. These rules could greatly harm the public and business community where I live and work, and could encourage banks to engage in activities which would impede them from meeting our community's basic financial service needs.

Sincerely,

(Example 4)

SAMPLE COMMENT LETTER

Hoyle L. Robinson
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20424

Dear Mr. Robinson:

I am writing to express my strong opposition to the proposed amendments to 12 C.F.R. Part 332, which would encourage banks to get into the travel business. As a (job title) in the (business) with the (Company name) company, I believe these rules, if adopted, could seriously harm the travel consumer and the travel industry by subjecting consumer and industry alike to conduct not subject to uniform, nationwide professional rules and standards. I also believe that Congress, rather than an administrative agency, should write the nation's banking laws, and as you should be aware of the sale of travel services of federally chartered banks has been found by the courts, as well as other bank regulatory agencies, to be an illegal banking activity in part because of the harm likely to be caused to travel companies, a result clearly prohibited by federal banking laws.

At a time of consumer chaos and confusion in the banking and travel industry alike as a result of deregulation, it is not appropriate for the Nation's principal bank deposit insurer to encourage bank entry into the travel and other businesses for which banks are neither qualified nor created to run, thus increasing the risk to our community's financial stability. Furthermore, as someone dependent upon indispensable bank financial services for my business and personal affairs, I do not want my competitor to be in a position to determine the future of my business and personal finances, as well as those of my clients.

I strongly urge FDIC rejection of the proposed rules.

Sincerely,

PERSONAL
SICK
VACATION
WITHOUT PAY
PRESENT IN OFFICE

15 - GOVERNMENT AFFAIRS

PERIOD ENDING Feb. 9-15, 198

EMPLOYEE NAME	SATURDAY	SUNDAY	MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
BENNISON, JOHN			X	S	X	X	V
[illegible], LINDA [illegible] ANNE			X	X	X	X	X
O'HARA, BARBARA			X	X	X	X	X

John C. Bennison 2-14-85
DEPARTMENT HEAD SIGNATURE DATE

Brick Institute of America 11490 Commerce Park Drive, Reston, Virginia 22091 Phone: 703-620-0010

STATEMENT OF

JOHN P. GLEASON, JR.

PRESIDENT

BRICK INSTITUTE OF AMERICA

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 21, 1985

Statement of John P. Gleason, Jr.
before the
Senate Small Business Committee
February 21, 1985

I am John P. Gleason, Jr., President of the Brick Institute of America (BIA) headquartered in Reston, Virginia. My comments today are on behalf of the brick manufacturers.

The Brick Institute of America is the trade association that represents over 85% of the total U.S. brick production. Our Government Relations Committee has met several times in the past year, and the purpose of this presentation is to submit to you our concerns and legislative priorities for the 99th Congress.

For brevity, I will just summarize each priority issue, and where appropriate I have appended to this statement any background material our organization has developed.

ISSUE NUMBER 1: IRS AUTO/TRUCK/VANS RECORDKEEPING RULES. This paper-generating provision is clearly interfering with normal business operations. This is predominantly a paperwork issue because of the excessive and unnecessary recordkeeping requirements and not a tax policy question. We are not seeking a free ride for personal use of company vehicles, but we strongly object to the unrealistic burdens imposed in order to obtain a legitimate business deduction. We urge the Committee to work for relief for the small business community.

ISSUE NUMBER 2: TAXATION OF FRINGE BENEFITS. We are aware that the Administration and Members of Congress wish to place a cap on the amount of tax free fringe benefits received by employees, including automobiles. In the past, tax policy has encouraged companies to establish and expand retirement and welfare programs. BIA is opposed to taxing of any employee benefits, including the use of an auto or truck as a fringe benefit.

ISSUE NUMBER 3: PENDING TAX PROPOSALS. BIA takes the same position on this issue as the Small Business Legislative Council and that is that public policy should be based upon incentives for entrepreneurs rather than increased tax burdens. Any tax reform proposal, in addition to simplification, should recognize and maintain basic economic incentives, and acknowledge the need for equitable distribution of burdens both in short-term budgeting measures and long-term tax structure. We will resist vigorously any changes of an anti-capital formation nature, such as dilution or repeal of the Investment Tax Credit, Depletion Allowances, and Accelerated Cost Recovery.

ISSUE NUMBER 4: FEDERAL BUDGET DEFICIT. The financing of large government deficits each year consumes much of the capital that would otherwise be available for the business investment needed to improve productivity and create jobs.

BIA strongly urges a lowering of deficits through reductions in the growth of Federal spending. We also support Congressional passage of a balanced budget amendment to the Constitution. Special emphasis should be given to the Grace Commission Report which has identified numerous areas where large savings can be achieved through the adoption of more cost efficient procedures. We urge the prompt implementation of these recommendations.

ISSUE NUMBER 5: SMALL BUSINESS ADMINISTRATION. BIA would be opposed to the Administration's proposal to eliminate the SBA. We feel that many of the present SBA programs could be eliminated and certain functions transferred to other agencies. A total careful review of all SBA activities should be carried out by your Committee with the help of the private sector. There are many new creative services that the excellent SBA staff could and want to offer the small business community, but are prevented by budget constraints. However, any new programs that are introduced should not be done, without elimination of any outdated inefficient SBA programs.

ISSUE NUMBER 6: EQUAL ACCESS TO JUSTICE ACT (EAJA). We urge reintroduction of this legislation and support EAJA reauthorization.

The following issues are also of great concern to our organization, but in order to avoid being redundant, I refer you to the statement submitted to this Committee by Mr. Walter Galanty, Jr., Chairman of the Small Business Legislative Council, whose views we endorse on the following issues:

ISSUE NUMBER 7: FULL AND OPEN COMPETITION IN FEDERAL PROCUREMENT.

ISSUE NUMBER 8: CORPORATION FOR SMALL BUSINESS INVESTMENT.

ISSUE NUMBER 9: CAPITAL GAINS TAX DEFERRAL ON REINVESTMENTS IN SMALL BUSINESS.

ISSUE NUMBER 10: DIRECT TAX WRITE-OFF FOR INVESTMENTS IN SMALL BUSINESS BY INDIVIDUALS.

The next issues presented in this statement are also of major concern to our Association, and are ones in which we anticipate the 99th Congress will be involved:

ISSUE NUMBER 11: PLANT CLOSING LEGISLATION. Legislation (H.R. 2847) was proposed providing extensive regulation of plant closings and layoffs. The bill would have mandated written advance notice of at least one year if more than 100 employees would be affected. BIA was opposed to the bill and plant closings legislation in general. Similar measures are expected in the 99th Congress which we would not support.

ISSUE NUMBER 12: DAVIS-BACON ACT. The Davis-Bacon Act requires contractors to pay "prevailing" wages on federally funded construction projects. This requirement unnecessarily inflates project costs. Because of the act's misclassifications, erroneous definitions of "locality" and inaccurate determinations of "prevailing" wages, BIA favors legislative and regulatory modifications. Although Senate and House reform bills were introduced, there was no action taken. We would hope reform bills would be introduced in this Congress, and urge their quick passage.

ISSUE NUMBER 13: IMMIGRATION REFORM. In the final days of the 98th Congress, a bill which would have reformed the nation's immigration laws died when House-Senate conferees reached a stand-off over federal cost reimbursement to the States. There were a number of provisions of the bill, including amnesty for millions of immigrants, employer sanctions and the creation of a new Immigration Board within the Justice Department to prosecute claims of discrimination against a special class of aliens. It is expected immigration reform bills will be reintroduced in 1985, possibly without provisions calling for the legalization of aliens. BIA will continue to support immigration reform, but fight the creation of a new board within the Justice Department and the outrageous employer sanctions that were included in the previous bill.

ISSUE NUMBER 14: ENVIRONMENTAL QUALITY. There are three major areas of this issue, The Superfund Reauthorization, Clean Water Act Reauthorization, and the Clean Air Act Reauthorization/ Acid Rain.

BIA supports reauthorization of the Superfund in the 99th Congress, but opposes proposals to expand the size and scope of the fund beyond the cleanup of abandoned hazardous waste sites.

The Clean Water Act Reauthorization did not pass in the 98th Congress. The present Act requires businesses to comply with complex regulations requiring the issuance of permits allowing certain discharges and setting standards for waste water pretreatment. BIA is not opposed to this concept, but we feel the system could be streamlined to make it more efficient. This should be a major goal of any legislation introduced in the 99th Congress.

Finally, we feel that more research needs to be done before Congress can propose any legislation relative to Acid Rain.

ISSUE NUMBER 15: PRODUCT LIABILITY TORT REFORM. In the last Congress, much needed uniform federal guidelines passed the Senate Commerce Committee, but Congress adjourned without a Senate floor vote. We strongly support and encourage this legislation to be passed by the 99th Congress.

ISSUE NUMBER 16: HIGHWAY FUNDING/ICE. The Interstate Cost Estimate (ICE) is a document put together by the Federal Highway Administration that dictates how federal funds for interstate highway construction are to be allocated among the states. Until Congress approves the ICE, these funds cannot be spent. In the last two years, this routine Congressional approval has been delayed repeatedly because controversial amendments and special projects were added to the ICE.

At the present time, forty-five states are completely out of interstate highway funds because Congress has not acted. We urge you to vote approval of the ICE. The second construction season may be lost if Congress does not act quickly.

Thank you very much for allowing me to present our views to you. We appreciate your interest, and look forward to working with your Committee in the future.

NATIONAL TOOLING &
MACHINING ASSOCIATION

9300 LIVINGSTON ROAD, FT. WASHINGTON, MD 20744
301/248-6200

TESTIMONY OF

WILLIAM E. HARDMAN

OF THE

NATIONAL TOOLING & MACHINING ASSOCIATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

February 6, 1985

Mr. Chairman and Members of the Committee:

Good afternoon. My name is William E. Hardman. I am the President and Chief Operating Officer of the National Tooling and Machining Association. Our industry is composed of 14,000 small contract metalworking companies. While our typical member will have 15-25 employees, they are perhaps the most highly skilled workers in the country. They use state-of-the-art equipment ranging from the simplest lathe to the most complex numerically controlled machining center. They can produce the desired part to within 1/10,000 of an inch in tolerance and surface finishes in millionths of an inch when necessary.

Our industry is at the apex of the manufacturing process. The skilled journeyman in this capital intensive industry provide the tooling, including tools, dies, fixtures, and precision machined parts, which enable the mass production of virtually every product in an industrialized society.

We appreciate the opportunity to suggest legislative priorities for the small business community in this Congress. We believe that there are some very important problems facing small business in 1985 and that the Senate Small Business Committee should thoroughly investigate and aggressively pursue a solution to those challenges.

One of the most outstanding successes of the small business community in 1984 was the enactment of legislation, originated in this committee, mandating the increased use of competition in the procurement of goods and services from the federal government. Currently, executive agencies are promulgating regulations to implement this legislation. It is no secret that elements within some agencies, particularly the Department of Defense, strongly opposed legislation mandating increased competition. Many of these same individuals will be interpreting the intent of your legislation as they draft regulations to implement the bill. Therefore, we strongly suggest that this committee conduct on-going oversight hearings to determine whether or not the regulations being drafted properly reflect the intent of Congress. If possible, the committee should provide feedback to procurement regulators in cases where Congressional intent has been overlooked or misinterpreted. Remedial legislation may be necessary later in the session to correct misinterpretations of technical problems.

Another area of great concern, particularly to manufacturers in the small business community is the relationship between the United States and its trading partners. There is increasing evidence that the concept of free and open trade, long supported by the small business community, has evolved into a situation of less than "fair" trade in the current international trading relationships. International dominence in many economic areas today is less dependent on competition between the most efficient company and more dependent on the degree of subsidization that industry enjoys from its national government.

As a result of international trade agreements negotiated at a time when the U.S. was the preeminent industrial power in the world, concessions have been built into our trade relationships which are not necessarily appropriate in the 1980s, a time when most of our trading partners are every bit as technologically advanced as U.S. industry. Currently, foreign governments may legally subsidize our competitors to any level they wish so long as it can not be proven that the primary purpose of the subsdidy was to increase exports. Nevertheless, it is clear that a heavily subsidized industry will eventually gain the lion's share not only of its own market, but also of foreign markets where its competitors are unsubsidized. Such is the case with many electronic products no longer available in the U.S. and to a large degree with many other products as well.

The implications of current trade policy are very threatening to the U.S. industrial base as well as to our nation's economic survival. A nation cannot survive without an industrial base. It cannot defend itself. A service economy eventually becomes the economic prisoner of a manufacturing economy. To allow this trend to continue would be to resign ourselves to the fate of the American Colonialists under British rule.

Obviously, this problem has been in the public arena for many years and a simple solution is not readily apparent. We do not yet have a comprehensive solution to the challenge ourselves, but we do have several suggestions which we feel should be considered as part of a solution to the current unfair trade imbalance. First of all, our own tax system discourages exports and encourages imports and we have no one to blame but ourselves for this problem. Most of our effective trading partners use a consumption-based tax. Exports from the country of origin are not subject to the consumption tax while imports to the same country are subject to the tax. Conversely, under our tax system products from a foreign country, under a consumption-based system, pay no consumption tax when sold in the U.S. A consumption tax is collected on U.S. products exported to this same country in addition to any U.S. taxes paid before export. Part of the solution would be for the United States to adopt a consumption-based tax as a partial, or even total, substitute for a corporate tax. Structured properly, the net price of products manufactured and sold in the United States would not change because declines in corporate taxes would be matched by a consumption tax of the same magnitude. An additional benefit is that imported goods would be subject to this same tax, as they should be, and goods exported from the U.S. would be more competitive in foreign markets because consumption taxes are normally collected from the ultimate consumer.

Another part of the solution would be to negotiate with our trading partners some limit on the use of domestic subsidies which would be based proportionate to each country's gross national product. Such an agreement would force our trading partners to be selective (as we are) about which industries would be subsidized and to what degree. For example, Japan might wish to provide very heavy subsidies to their electronics industry, just as the United States might choose to continue the subsidy of our farmers. At some point, however, each of our trading partners (and the U.S.) would reach the limit of their allowable subsidy. That would be far more desireable than the current situation where much of the success of our foreign competitors is the result of broad subsidization of many different industries simultaneously while the U.S. government has been far more selective in providing subsidies to business.

These two major issues will require much work and effort if they are to be resolved in this Congress. Because of the magnitide of the challenege, we recommend that the committee begin to focus on them as soon as possible. At the same time, there are a number of very important issues which need to be addressed in the short term.

The first is the elimination of the Internal Revenue Service regulations for recordkeeping for automobile use and entertainment. A broad coalition of small business groups strongly supports legislation introduced into the Senate and House of Representatives which would repeal those rules. The support of the members of this committee in terms of cosponsorship of the Senate legislation and in garnering the support of your fellow Senators for the measure would be a great service to the small business community. The strongest argument against the regulations are that they will raise a lot more headaches than revenues. The ultimate cost to the small business owner is far greater than the benefit provided by the original modest revenue estimates of the Treasury Department.

A second issue which must be addressed very quickly is the Federal budget and, of course, the reauthorization of the Small

Business Administration. We commend the committee for its efforts to preserve the Small Business Administration and will join with you in trying to convince your colleagues and members of the administration of the importance of this agency to small business. At the same time, we need to recognize the paramount importance of reducing the federal deficit through budget reductions. If the Small Business Administration is to take a budget cut to help achieve that goal, then no department should be exempt from efforts to reduce their budget by eliminating programs or improving efficiency (the latter is another reason for the close monitoring of last year's competition legislation).

Finally, another major issue which will closely follow the federal budget, is the question of tax simplification. The Chairman of the House Ways and Means Committee and the Chairman of the Senate Finance Committee have both stated that they have little interest in a tax simplification bill which is revenue neutral. As a result, it would be likely that any tax simplification would include a significant increase in business taxes in one form or another. We urge you to strongly oppose the administration's tax simplification proposal as well as other tax simplification proposals for that reason. What is needed is not a short-term tax bill to raise revenues by reducing incentives for investment, but rather a long term approach to developing a tax system which encourages a strong U.S. industrial base.

Thank you very much.

AICPA

American Institute of Certified Public Accountants
1620 Eye Street, N. W., Washington, D. C. 20006 (202) 872-8190

February 15, 1985

The Honorable Lowell P. Weicker, Jr.
Chairman
Senate Committee on Small Business
Washington, DC 20510

The Honorable Dale Bumpers
Ranking Minority Member
Senate Committee on Small Business
Washington, DC 20510

Dear Chairman Weicker and Senator Bumpers:

The American Institute of Certified Public Accountants' (AICPA) Committee on Small Business appreciates the opportunity to present its views as you formulate your committee's work plan for the 99th Congress.

The AICPA is the professional organization representing approximately 230,000 CPAs in the United States. The AICPA, through the efforts of volunteer members working within over 100 committees, subcommittees, and boards is devoted to organizing the body of accounting knowledge, conducting research, and establishing and enforcing the accounting profession's technical and ethical standards along lines that serve the broadest public interest.

The AICPA's Small Business Committee is primarily interested in promoting the success of small business. Accordingly, we are pleased that your committee's agenda will deal with such diverse issues as tax simplification, paperwork reduction, Equal Access to Justice, government procurement and the family farm as well as the multi-year authorization bill for the Small Business Administration (SBA).

We, too, are concerned about all matters that affect small business. Our committee is especially interested in any revisions to the tax code that affect small business and the administration's proposal to abolish the SBA. Small business is a dynamic force in the Nation's economy. It employs 47.8 percent of the private non-farm work force, contributes 42 percent of sales; and generates approximately 38 percent of our Nation's Gross National Product. Any effort to reduce the centralized government focus on the needs of the small business owner should be carefully weighed. Therefore, we believe that decisions affecting small business should be made only after careful study and analysis of all the relevant data.

Our committee also believes that the 1986 White House Conference on Small Business should be held. We think that long-range benefits to small business owners and their employees will be identified as a result of the 1986 White House Conference. To demonstrate our support for the conference, we have offered our assistance to the SBA in conducting it. A copy of my December 20, 1984, letter to James C. Sanders is enclosed. We believe that this is a worthwhile conference and the necessary planning should begin as soon as possible.

Again, thank you for this opportunity. We hope that you will include the AICPA in your committee's deliberations. If we can ever be of assistance to you or the committee, please do not hesitate to contact me or Joe Moraglio in our Washington office.

Sincerely,

Bruce J Harper

Bruce J. Harper
Chairman
Committee on Small Business
American Institute of Certified Public Accountants

BJH:md

Enclosure

STATEMENT

OF THE

INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Submitted to the

SENATE COMMITTEE ON SMALL BUSINESS

HON. LOWELL WEICKER, CHAIRMAN

Regarding

ISSUES FACING THE 99TH CONGRESS AND THEIR IMPACT ON SMALL BUSINESS FINANCING

February 6, 1985

We are pleased to submit this statement to the Senate Small Business Committee on behalf of the Independent Bankers Association of America, which represents approximately 7800 small and medium-sized commercial banks located in smaller and medium-sized towns and suburban communities across the United States. Our member banks make the major share of their commercial loans to small business and agriculture. We are therefore vitally concerned about the issues before this Committee and the 99th Congress.

As you know, small business and small banks are tied together as if by an umbilical cord. You've seen the studies which show that roughly three quarters of all loans to small business are made by small and medium-sized banks. Ninety-seven percent of the commercial loan portfolios at banks with less than $100 million in assets, and 77 percent of loans at banks with between $100 million and $100 billion in assets, are small business loans. In contrast, banks of more than $1 billion in assets make only 13 percent of their commercial loans to small business. You are also familiar with the attitudinal surveys conducted by the Small Business Administration (SBA) and the National Federation of Independent Business (NFIB) which indicate that small firms prefer to deal with small banks which know them and their business personally. These facts are well established.

The Non-Bank Bank Problem

Perhaps the greatest single threat to maintaining this lifeline of financing for small business is the spread of so-called non-bank banks, many of which are chartered to take deposits but not to make commercial loans. By definition the so-called non-bank bank can only meet the test of the legal loophole in the Bank Holding Company Act if it either does not take demand deposits or make commercial loans. To date, nearly 75 such institutions are already operating, 190 have received preliminary approval, and roughly 200 charter applications are pending. Most are from a handful of large banks. Few of these would make commercial loans. Whatever deposits they collect will be removed from the local community's pool of money available for loans to area businesses.

It is not surprising, therefore, that the NFIB, the National Small Business Association, and the Small Business Legislative Council (SBLC) have supported closing the non-bank bank loophole. The Small Business National Issues Conference held in June of 1984, which brought together representatives of the major small business associations, took the position that "Congress should act immediately to...close the non-bank bank loophole," which it was felt "has the potential of seriously interrupting the flow of debt financing available to small business."

More recently, the SBLC's Policy and Issues conference held in early January took a position on nonbank banks. The SBLC is made up of 88 trade associations with memberships totaling over 4 million small businesses. The SBLC voted to "urge Congress to take legislative action to close the nonbank bank loophole as soon as possible."

Legislation that would close the non-bank bank loophole passed both the House and Senate Banking Committees in 1984 and similar bills have already been submitted in the House this year. Although the Comptroller of the Currency has approved numerous nonbank bank charters since Congress adjourned in 1984 without closing the loophole, a suit filed in the state of Florida has temporarily put a halt to issuing new charters. We strongly urge the members of this Committee to do everything in your power to see that loophole closing legislation is brought to the floor in the Senate and then passed in both houses of Congress.

The Importance of the SBA & SBA Programs

Deregulation of the interest rates banks can pay on deposits has already had an impact on the financing available to small businesses. Real interest rates are higher and more volatile than before and the greater uncertainty in the cost of funds has all but eliminated the ability of banks to make long-term, fixed rate commercial loans. In such an environment the SBA loan guarantee program has played a critical role in making this important form of financing available to small firms. A recent GAO report indicated that nearly 40% of long-term, fixed rate loans to small businesses were made in conjunction with an SBA guarantee. Only last year, the President signed into law a bill which authorized the pooling of SBA guaranteed loans for resale on the secondary market, a program designed to increase the availability of such loans. IBAA supported this legislation because we believe that an expanded secondary market will help banks to make more long term loans.

We are therefore greatly concerned about the Administration's proposal to eliminate funding for SBA in the 1986 budget. The IBAA strongly supports continued existence of the SBA and its loan guarantee programs as part of an independent agency. The guarantee programs have been improved tremendously in recent years. The Certified and Preferred Lenders Programs have removed the key credit decision process from the SBA and placed it with private lenders, which have extensive credit experience and know their business community intimately. It would be a tremendous disservice to the small business community to discontinue or curtail the guaranteed loan programs under SBA. The IBAA pledges to help this Committee in its efforts to keep the SBA alive and in the business of guaranteeing loans.

Regulatory Inequities

In the absence of major banking legislation during the past two years, the principal thrust of deregulation has come from the regulatory agencies, sometimes in ways that run counter to the intent of Congress. In regard to the actual supervision of banks by the regulatory agencies, several recent developments and proposed reforms that have been wrapped in the cloak of deregulation may cause serious problems for small banks and, in turn, small business.

The most obvious and potentially damaging example of this is the inequitable manner in which regulators have handled large and small banks that are failing. While troubled small banks have simply been closed down and insured depositors paid off, giant Continental Illinois was saved with Federal Reserve and FDIC funds and an announcement was made that all of its deposits, including those above $100,000 and uninsured foreign deposits, would be fully protected. Not long after this bailout, the Comptroller of the Currency testified before Congress that the very largest banks were indeed "too big to fail." The clear message of these regulatory actions is one that has been trumpeted throughout the national media: your money is safer in large banks than in smaller depository institutions. This message grows more ominous and unfair when it is realized that the "fail safe" money center banks supported by the Administration are striving to extend their direct deposit taking reach nationwide.

The FDIC admits that this double standard exists and claims that it is trying to rectify the situation. Yet it continues to push for increased disclosure of financial information on banks in the hope of bringing "market discipline" to the banking system. But as long as investors and depositors believe that big banks cannot fail due to government support, market discipline would only work against smaller banks, driving deposits away from local markets that serve community business and toward money center banks.

The Continental affair also dramatized the inequities that exist in the deposit insurance system and have spurred a drive for deposit insurance reform. The Cabinet Council on Economic Affairs has stated that "the insurance systems appears to treat large and small depository institutions differently, raising substantial public policy questions". Under the current system, riskier banks are encouraged in their risk-taking because all banks pay the same insurance premium. A glaring example of this is the fact that foreign deposits are not insured by law and thus not assessed for premiums. Yet Continental Illinois received full coverage of foreign deposits which made up more than half of its total deposits.

Foreign deposits totaled $347 billion as of March 1984, nearly all of which is in the largest banks. Almost 40 percent of money center deposits come from foreign sources, and some banks get more than half of their funds outside the U.S. Senator Proxmire has stated that Continental Illinois' reliance upon foreign deposits cut its annual premium by $14 million. The upshot is that large banks aren't paying their fair share into the insurance fund, yet Continental was able to tap $4.5 billion from the fund for assistance. Senator Proxmire last year offered an amendment to the Garn bill to end this glaring inequity, and we urge members of this Committee to support doing so as a part of a total insurance reform package.

For the reasons cited above, reform of the deposit insurance system is a high priority for small banks. The Cabinet Council on Economic Affairs has come forward with recommendations in this area, and the FDIC is pushing its own reform proposal . A central aspect of the proposals is assigning premiums based on a bank's riskiness, a concept that community banks support. A system of risk-based premiums must be developed in such a way that for the large banks pay into the insurance fund an amount that fairly represents the risk that they place on the system itself.

Consolidation in the Banking Industry

It is also worth touching on the subject of anti-trust laws and the concentration in banking that may be brought on by deregulation. A researcher at the Federal Reserve Board recently did a computer simulation of the concentration among banks that would be allowed under current anti-trust guidelines if geographic restrictions were to be removed. The results, presented before the Housing Banking Committee in May, were rather incredible.

According to the testimony, Justice Department guidelines would allow dramatically increased levels of concentration in virtually every one of the 318 SMSA banking markets in the country. Banking organizations in these areas could be reduced from 6,585 to 1,801, reducing the average number of banks in an SMSA from 20.7 to 5.7. Mergers would be allowed to the point where every metropolitan banking market in the country would be highly concentrated. The author of this study ventured the opinion that this type of merger concentration was unlikely to occur, but it certainly dramatizes the fact that existing anti-trust laws will have very little effect as geographic boundaries break down. Regretably, none of the legislation submitted before Congress during its last session addressed the anti-trust question.

The results of this type of anti-trust policy as applied to banking are already becoming apparent. A more recent study by Fed staff shows that the number of bank mergers approved during the first three years of the Reagan Administration was nearly double the number during the entire four years of the Carter Administration. According to the study, the principal factor behind the increase in merger approvals is the lenient anti-trust posture adopted by the current administration. Therefore, we feel strongly that any further geographic deregulation will need to be accompanied by revised anti-trust standards for banking.

To summarize, as deregulation of the financial services industry unfolds it is critical to keep in mind the long-standing reliance of small businesses upon local banks to meet their credit needs. It cannot simply be assumed that new competitors entering the financial services market will be willing or able to serve small business. We believe strongly that community banks can prosper and continue to serve the small business market in the years ahead. But for them to do so when faced with unfair competition from outside the bank regulatory structure and inequitable treatment by bank regulators will be extremely difficult and can only be harmful to the interests of small business.

**Coalition
for
Common
Sense
in
Government
Procurement**

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February 22, 1985

The Honorable Lowell Weicker
Chairman
Senate Committee on Small Business
Room 428A
Russell Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

This letter responds to your request for a statement concerning the small business issues which are of top priority to the Coalition for Common Sense in Government Procurement.

The Coalition is a non-profit membership organization of large and small businesses that sell commercial products to the federal government. Approximately 80% of our membership consists of small businesses. In addition, our Board of Directors consists of ten trade associations who represent our members' various industries. The associations who make up our Board are:

- Association for Information and Image Management (AIIM)
- Business and Institutional Furniture Manufacturer's Association (BIFMA)
- Computer and Business Equipment Manufacturer's Association (CBEMA)
- Information Industry Association (IIA)
- National Association of Manufacturers (NAM)
- International Communications Industries Association (ICIA)
- National Office Products Association (NOPA)
- National Association of Photographic Manufacturers (NAPM)
- National Association of Wholesaler-Distributors (NAW)
- Scientific Apparatus Makers Association (SAMA)

Since its formation in 1979, the Coalition has taken an active interest in federal commercial product procurement policies. We have testified before Congress on a number of issues, including proposed federal prompt payment legislation and OFPP's "Uniform Federal Procurement System." We have filed numerous comments with The General Services Administration and other government agencies concerning procurement policies that affect our members. We also worked closely with GSA in developing the current policy for negotiating multiple awards schedule contracts.

The most significant problem facing our members today concerns a recent trend in the General Services Administration's procurement policy which threatens to substantially reduce small business participation in the federal marketplace. This trend involves GSA's systematic conversion from a "multiple award" contracting system to a "single award" contracting system. The Coalition had the opportunity to participate in a House Subcommittee hearing last August concerning the impact that GSA's single award contracting system was having on small businesses. A copy of the hearing transcript is enclosed with this letter for your review. We would like to call your committee's attention to the impact this shift in procurement methods is having on the small business community. Before discussing that impact, however, we think it would be helpful to provide a brief overview of how the multiple and single award contracting systems work.

The multiple award system was established to give federal agencies a method by which they could make their small dollar commercial purchases with a minimum of paperwork and time and yet receive reasonable prices through discounts. Because the government has such a mass of personnel spread across the country, there is no way to dictate or forecast what features will be required of the commercial products the agencies want or the volume they would be buying them in. Therefore, the system was designed to provide agencies a choice in, and quick delivery of, the products they required. The system also provides a dollar cut-off point beyond which agencies must use another procurement method to purchase their higher volume quantities. This limitation on the size of orders placed under multiple award contracts was built into the system so that agencies could take advantage of greater discounts that can be received on high-volume purchases.

Under the multiple award contracting system, GSA negotiates contracts with multiple vendors for similar -- but not identical -- products. No specifications are used in this system. Instead, vendors are provided a brief description that allows them to bid products that are already commercially available. The only criteria that potential contractors must meet are that the products must be commercially acceptable, and that the government receive a discount equal to or better than that given the vendor's best commercial customer.

Once contracts are awarded, GSA publishes a supply schedule listing those contracts, while each contractor provides user agencies with a catalog and price list containing pictures, prices and other ordering information. Agencies may determine which products best meet their requirements and order the lowestpriced product that suits their needs. Agencies order directly from the contractor, and all future transactions take place between the ordering activity and the vendor.

Under the single award system, GSA solicits offers from various vendors based on a commercial item description (CID). A CID is a basic specification which lists the product's essential characteristics. Once the offers are in, GSA awards the contract to the single vendor who makes the best overall offer, price and other factors considered. The contractor who wins the single award becomes the Federal Government's sole approved supplier for that particular item. If agencies need a copier or typewriter or piece of furniture and a single award exists for that item then agencies must make their purchases from the contractor holding the single award. No flexibility exists for agencies to select a product that may be better-suited to their needs.

The single award virtually eliminates small business participation in the Federal Supply Schedule contracting program. Under the multiple award system, both small and large businesses are able to compete equitably on price, warranty, service, training and installation. The very nature of single awards, on the other hand, generally precludes small businesses from competing for award. A single purchase by the government is usually a very large purchase. This severely limits the ability of small firms to compete because they are not equipped to supply the large quantities required by the contract. In addition, they are not able to compete with large firms on price and they are often not able to re-tool their plants within enough time to start production under the terms of the contract. Small businesses also have more difficulty than large businesses in obtaining financing to expand their facilities so that they might respond to a single award solicitation.

Many of the small businesses currently doing business with the federal government under the multiple award system are independent dealers who suffer greatly under single award procurements. Single awards severely limit the ability of dealers to compete because a single award is determined by "best price" and dealers are hard pressed to beat a manufacturer's best price.

For the reasons outlined above, the single award contracting system discourages small businesses from submitting offers for GSA single award schedule contracts. The Coalition believes that reduced small business participation in the federal marketplace works to the detriment of the federal government by limiting competition. As qualified contractors are discouraged from bidding, the pool of suppliers diminishes and competition dries up. And as the competition dries up, so do GSA's chances of receiving better prices.

The single award system is also hurtful to the general economy. As you know, the government pumps millions of dollars each year into small firms to keep them from failing, while at the same time giving large firms numerous tax advantages to help ensure their success. All of this money is essentially a form of taxpayer dollars.

The multiple award contracting program allows businesses of all sizes to earn profits to help ensure their solvency. They compete for a large or small share of the federal market, depending on what they can responsibly supply. In the process, they employ people, pay taxes and support the economy.

The more firms excluded from selling to the government by going to single awards, the more tax dollars the government loses, in many ways. Members, large and small, tell us that they will close offices and reduce staffs should they lose the federal market business they have cultivated through the multiple award system over the years.

The Coalition believes that the multiple award system is the surest way for the government to stimulate small business participation in the commercial product contracting system. Multiple awards ensure that prices remain low and that quality remains high because numerous contractors must continue to compete against each other for government business even after their contract has been awarded. This marriage of commercial competetion to government discount standards produces the lowest competitive price for commercially acceptable products.

The multiple award system works to the government's advantage in other respects as well:

- It creates more effective distribution of business between large and small suppliers;
- It is consistent with the Administration policy of promoting small business activity and adding jobs to the economy;
- It enjoys greater acceptance by industry and therefore ensures greater competition because it encourages more businesses to participate in federal procurement programs;
- It provides a wider selection of items and thus ensures that agencies will be able to get low, reasonable prices on products best suited to their needs;
- It produces marketing and servicing practices that parallel those in the private sector, ensuring that the federal government will not be given "second class" treatment.

The single award system does none of these things. We therefore recommend that GSA refrain from issuing any further single award solicitations until specific criteria have been developed for determining whether a product is suitable for single award. These criteria should include the impact single awards for that item would have on the Government's small business and other socio-economic policies. We further recommend that these criteria be developed through a joint effort by GSA, user agencies and industry. The Coalition will be pleased to work in cooperation with your committee to achieve this goal.

Sincerely,

Yvonne Kidd

Yvonne Kidd
Executive Director

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February 8, 1985

The Honorable Lowell P. Weicker, Jr.
United States Senate
303 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Weicker:

On behalf of our client, the Specialty Advertising Association International (SAA), a trade association of small business firms, we have been requested to supply you with a brief statement of SAAI's legislative priorities for the next two years. We commend you for seeking such information from our Association and other members of the small business community. This letter describes our priorities. It begins with a brief description of the specialty advertising industry and our client Association.

Specialty Advertising Industry

Specialty advertising products consist of useful items, such as ballpoint pens, key tags and calendars, that are imprinted with an advertising message and distributed free of charge for advertising or promotional purposes. Sales of specialty advertising products, including business gifts, exceed $3 billion annually.

Although most users of specialty advertising are business firms, the products are often used in situations unrelated to marketing. Many companies and organizations use advertising specialties internally to promote safety, to obtain money-saving suggestions or to motivate and recognize performance. Indeed, award programs, involving trophies, plaques, and other mementos of recognition are important elements in the business of many industry firms. Specialty advertising is also used by many non-business entities. For example, political parties and candidates have for many years used items, such as bumper stickers, buttons, and balloons in election campaigns and primaries.

There are approximately 7,000 companies in the specialty advertising industry, 1,500 of which are manufacturers (known as "suppliers") and 5,500 of which are distributors that actually sell the products to the advertisers. A few industry firms combine the manufacturing and distribution functions and are known as "direct selling houses." Virtually all firms in the industry are small businesses.

Legislative Priorities

1. Tax Treatment of Independent Contractors

Although Congress has enacted legislation providing an indefinite moratorium against the enforcement of employment taxes against persons that qualify for independent contractor status, a problem still exists for many firms in the specialty advertising industry that have independent contractor salespersons. The IRS moratorium is not absolute, can be lifted at any time, and provides no guidance for determining who is an independent contractor within the meaning of federal employment tax laws. Accordingly, SAAI urges the enactment of a law providing clear and simple "safe harbor" tests for determining independent contractor status.

2. Business Gift Deduction

Business gifts are a vital part of the specialty advertising industry. They play an important and legitimate role in American industry generally. They are given, usually at Christmas time, as an expression of appreciation. In 1962 Congress set a $25 limitation on the deductibility of business gifts in the Internal Revenue Code. Despite the enormous inflation that has taken place since 1962, the deductibility limit has not been changed. We believe it should be raised to $100 and that section 274 of the Internal Revenue Code should be amended accordingly.

3. Employee Awards

Presently, employer awards for safety, productivity, and length of service are deductible by the employer-donor up to $400 and up to $1,600 in the case of awards made in accordance with a written plan. Generally the value of the award is considered by the IRS to be taxable to the employee. Imposing a tax on the awards nullifies the salutory purpose of such awards and the goodwill of the employer in making them. We therefore urge that Congress enact legislation ensuring that such awards not be taxable to the employee in amounts up to $300.

4. Product Liability Legislation

The unpredictability and inequities of state product liability laws have made it almost impossible for interested parties to understand their rights and obligations. State product liability laws differ widely and make it possible for "forum shopping" by plaintiffs seeking the most favorable laws available. SAAI believes that Federal product liability legislation is needed to resolve those inequities and uncertainties. Such legislation should include provisions protecting distributor-wholesalers or "middlemen" from liability in cases where they neither see the product or have reason to know it is defective.

5. "Sales Representative Protection" Legislation

SAAI opposes the enactment of such legislation. We list it as a priority only because bills on the subject have been introduced in the past several Congresses and we believe the issue should be laid to rest. Such measures would constitute an arbitrary intrusion into private contractual relationships; restrict the parties freedom to bargain as they see fit; would be unnecessary to protect sales representatives and would increase the costs of goods and services sold by such persons.

6. Activities of the Small Business Administration

For more than 30 years SBA has stood as the sole government advocate for the small business community. SAAI strongly opposes the Administration's proposal to eliminate the

SBA. It is absolutely essential that the SBA continue to represent the small business community in the executive branch of government.

7. Contemporaneous Records for Motor Vehicles

Written contemporaneous records for verifying motor vehicle tax deductions is an additional paperwork burden that falls most heavily on the small business person who is least able to comply. SAAI is opposed to this requirement and urges its repeal by Congress.

8. National Fiscal Policy/Federal Budget Deficit

The Federal deficit must be reduced to sustain a healthy economy. SAAI believes that all Federal expenditures, as well as tax policies, should be carefully reviewed to bring expenditures into balance with revenues. Special emphasis should be placed on entitlement programs, defense programs and the elimination of waste, mismanagement and inefficiency in the daily operations of government. It is essential that there be both further spending reductions and encouragement of investment and employment rather than tax increases which would discourage further growth of the economy.

We would be pleased to discuss these issues in greater detail if you or a member of your staff so desire.

Sincerely yours,

Malcolm D MacArthur

Malcolm D. MacArthur
General Counsel,
Specialty Advertising Association
International

c: Mr. H. Ted Olson

CMAC Coalition For Multiple Award Contracts

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STATEMENT BY WILLIAM MUEHLEIB

CHAIRMAN, EXECUTIVE COMMITTEE

COALITION FOR MULTIPLE AWARD CONTRACTS

FOR THE RECORD OF THE

SENATE SMALL BUSINESS COMMITTEE MEETING

FEBRUARY 6, 1985

The Coalition for Multiple Award Contracts (CMAC) was formed by the National Office Machine Dealers Association NOMDA in cooperation with office machine manufacturers. The Executive Committee consists of five persons, three designated representatives of member manufacturing firms and two dealers appointed by NOMDA.

CMAC requests that the interests of small businesses attempting to sell their products to Federal and state government agencies be included in the Small Business Committee's agenda.

Two problems currently are preventing the nation's independent office machine dealers (which number in excess of 12,000) and the manufacturers who sell through dealers from competing fairly for sales of their products to Federal agencies. First, following a direction urged about six years ago by the General Accounting Office and a few Members of the Congress, the General Services Administration has been systematically converting products covered by Multiple Award Schedule contracts to single award contracts. Second, in spite of having issued a policy which seemed to say they would not do so, GSA is using the prices granted by manufacturers to their dealers as the basis of negotiation for Multiple Award Schedule contracts.

Regarding the conversion of products to single awards, the GAO and those Members who urged the present course believed that the Government would save money, since the price of a given product under a "competitive bid" is usually lower. Taken as a whole, however, it is doubtful that money has been saved on the office machines which have been converted to single awards.

For most office machines, operator training, installation, and technical support are important to end users. The competition among vendors for each individual sale keeps the quality of these services high enough to meet or exceed user needs.

Most office machines are currently subject to rapid technological advance and resultant price erosion. New suppliers are entering the field, further increasing price competition. The single award contracting cycle must include several months for writing Commercial Item Descriptions (CIDs) and solicitation documents, additional months for bidder responses and determination of the award winner(s), and then the contract term itself (usually one year). During this cycle of two years or more, technology is advancing and general price levels are being lowered. Single awards lock out most of these advances during much (or all) of this approximately two-year document development and contracting cycle.

Surprise introductions by some suppliers in such a rapidly developing industry may catch other suppliers with large quantities of less desirable products. Single award GSA contracts are likely to become a primary "dumping ground" for manufacturers who are "stuck" with such models.

Single award competitive bids are often the logical method to use for purchase of large single requirements of office machines or other products. Multiple Award Schedule Maximum Order Limitations (dollar limits beyond which agencies must place requirements out to bid) provide for this. However, when the requirements of all users are not identical, making separate purchases under multiple award schedule contracts is usually more advantageous to the Government.

Single awards may also be the best method for purchase of "commodities", if adequate quality control can be provided. Even for supply items, though, some agencies report that single awards have resulted in problems more costly than the difference between single and multiple award prices.

Regarding the basis of negotiation used in multiple award contracts for all types of commercial products, GSA's currently published policy requires vendors who sell through dealers to reveal the discounts they give to resellers (including dealers), but prohibits use of these discounts as the basis of negotiation of the discount(s) to be granted to the Government.

However, GSA requires that the government discount be equal to or greater than the discounts vendors grant to dealers (or other resellers) minus the value of functions performed by the dealer. Not all functions performed by dealers for other classes of users are considered. According to GSA sources, the cost of sales efforts, and clerical, administrative, management and overhead expenses at the dealer location are excluded from consideration. The costs of freight in, delivery, installation, operator instruction and warranty are allowed.

To allow this negotiating strategy within the limits of published policy, one must consider the basis of dealer discount minus the value of functions as "other than the...participating dealers...discount." Further, since costs cannot be used in negotiating contracts which are based on established market prices, one must also consider the costs of tasks performed by dealers to be the "value" of those functions.

This interpretation of negotiating policy discriminates against small businesses. The ability of any vendor to secure a customer's business depends first on performance, then on price. Office machine manufacturers provide distribution and user support primarily through dealers or branches. Vendors who sell through branches reveal only their end user pricing, which includes the sales, overhead, administrative and management costs incurred in local branches.

Under such a policy, suppliers who sell through branches are compensated for support of Federal customers, while those who sell through dealers are denied such compensation. This is clearly discriminatory. Even more important, lack of such compensation means that those who sell through dealers will be ineffective competitors since they cannot afford to provide services most agencies consider essential.

The Government, being large and complex, has long been a tough customer for the independent office machine dealer or the small office machine manufacturer to sell successfully. Most dealers responded by selling in other markets.

Now, technological advances have spawned numerous new products and forced greater reliance on dealer and other non-direct forms of distribution. Dealers now compete effectively in almost every product area and market segment. Unfortunately, if current policy continues to make dealers ineffective competitors in the Federal marketplace, dealers, small manufacturers and the Government will all lose.

CMAC wishes to thank the Chairman and Members of the Committee for the opportunity to submit this statement. On behalf of office machine dealers, manufacturers who sell through dealers, and those in other industries whose participation in the Government marketplace depends on a well-managed Multiple Award Schedule Program, we request that the Committee investigate GSA's management of programs for the purchase of commercial products and take whatever action is indicated by the findings and continuing policy developments.

NAM

Statement of

The National Association of Manufacturers

before the

Committee on Small Business
United States Senate

on

Small Business and Priorities

1985

February 6, 1985

INTRODUCTION

We appreciate the opportunity to present the views of the National Association of Manufacturers to the United States Senate Committee on Small Business. This statement will cover a number of subjects of interest to our small manufacturers, including Deficit Reduction, Efficiency in Government, Budget Reform, Tax Simplification, Contemporaneous Recordkeeping of Business Vehicles, Product Liability, Equal Access to Justice, the Small Business Administration, Superfund Reauthorization, Acid Rain and Freedom of Information Act Reform.

The National Association of Manufacturers is a voluntary business association of over 13,000 corporations. Members range in size from the very large to over 9,000 small manufacturing firms, each with an employee base of less than 500. NAM member companies employ 85% of all workers in manufacturing and produce over 80% of the nation's manufactured goods. NAM is affiliated with an additional 158,000 businesses through its Associations Council and the National Industrial Council. Over 70% of these additional affiliations are small.

With its significant small manufacturing membership base, NAM clearly maintains a strong interest in the economic future of the small business community.

The issues we discuss today are of primary importance to small manufacturers and are among the top priorities for the National Association of Manufacturers. Policies enacted by the NAM are reviewed by a five-member Small Manufacturers Steering Committee prior to consideration by the full Board.

DEFICIT REDUCTION

Of critical concern to small manufacturers is the state of our nation's economy and the opportunities presented for expansion and growth. No segment of NAM's membership is more vociferous and outspoken in support of spending reductions as a means of lowering the federal deficit.

Each year, more than $100 billion that could be put into more productive activity through investment in housing, inventories, plant and equipment, is consumed through interest payments. As the government goes into the credit markets to finance this debt, the amount of capital available for investment is severely depleted.

The National Association of Manufacturers supports a one-year, across-the-board federal spending freeze as a means of reducing the federal deficit. It is our belief that such a freeze, applied across the board with all recipients and programs sharing equally, would result in a $35 to $40 billion cut in Fiscal Year 1986, $70 billion in FY 1987 and $90 billion in 1988.

EFFICIENCY IN GOVERNMENT

Small Manufacturers have little or no room in their operations for inefficiency or waste, and are therefore angered by accounts of waste, fraud, and abuse in the federal government. The President's Private Sector Survey on Cost Control, also known as the Grace Commission, has identified numerous areas where large savings can be achieved through adoption of more cost efficient procedures.

NAM encourages the prompt enactment and implementation of these proposals as one of Congress' highest priorities.

BUDGET REFORM

The National Association of Manufacturers supports changes in the federal budgeting procedures that would eliminate the built-in bias which provides great political advantage in supporting new and larger spending programs, but little or no political opportunity in opposing them.

NAM supports a comprehensive package of improvements (such as multi-year budgeting and greater enforcement of reconciliation) and urges prompt consideration of such improvements.

The provisions of this package are contained in an appendix to this statement.

TAX SIMPLIFICATION

Smaller businesses today are the primary generator of new jobs and technological innovation in the U.S. economy. Yet these businesses continue to suffer from the high cost of capital that effectively limits their potential contributions to the economy. Firms are being deprived of the ability, if not the opportunity, to expand, develop new products, increase inventory and purchase new equipment.

Most small businesses today do not have convenient access to sources of available capital such as venture capital markets, the public sale of equity securities and bond issues. Instead, much of the capital available to smaller businesses comes from friends, relatives, business associates and personal savings.

Adequate incentives must be provided for both savings and capital investments, so that we may restore productivity and expand economic growth. The Treasury Department's proposal to eliminate the Accelerated Cost Recovery System (ACRS) and the Investment Tax Credit (ITC) would critically injure the small manufacturer's incentives to invest. Combined with a proposed flat corporate tax rate of 33%, effectively doubling the income taxes of some smaller companies, such injuries could be fatal to many small manufacturers.

The National Association of Manufacturers continues to be generally supportive of efforts to simplify our nation's tax structure, but such simplification cannot come at the expense of capital formation and small business. NAM therefore vigorously opposes anti-capital formation changes to the tax law.

COMTEMPORANEOUS RECORDKEEPING OF BUSINESS VEHICLES

Armed with the Deficit Reduction Act of 1984 mandate to close fringe benefit loopholes, the Treasury Department has issued two sets of proposed regulations which would drastically limit the amount of investment tax credit and depreciation that could be claimed on a business vehicle. These regulations would require that personal use of business assets be taxed to the users as non-cash compensation, and require that every mile driven be logged with reference to purpose, person, and place.

These regulations go far beyond existing law. More acutely, they are unnecessarily burdensome and unworkable requirements that fail to consider customary business practices.

These regulations impact severely on small business requiring a significant expenditure of man-hours, a limited resource in any small endeavor, to be spent in pursuit of minutiae for the benefit of the Internal Revenue Service.

The NAM supports repeal or, at the very least, a reduction of these monumental recordkeeping requirements along with the amount of income an employee must report for the personal use of a company vehicle.

PRODUCT LIABILITY

The confusion of 50 varying and inconsistent legal standards and rules, and their application produces unnecessary costs, legal unfairness and uncertainty. Small manufacturers are less able to absorb the costs coincident with current product liability laws, nor are they as able as larger firms to seek alternative options such as self-insurance.

Small manufacturers today face liability insurance premium increases of up to 400%. With such premium costs already constituting a very high percentage of business costs, the alternative for many will be to go out of business.

The National Association of Manufacturers therefore supports S. 100, the product liability reform bill introduced by Senator Robert Kasten.

We strongly urge the members of this committee to support your colleague's proposal which would provide viable, uniform federal guidelines in the area of product liability and, as a consequence, offer a moderating influence on rapidly escalating product liability costs.

EQUAL ACCESS TO JUSTICE

The National Association of Manufacturers urges the passage of legislation permanently reauthorizing the Equal Access to Justice Act (EAJA) and expanding the jurisdiction of the Act to apply to all federal agencies including the Internal Revenue Service. The primary purpose of the EAJA is to provide for the award of attorneys' fees to prevailing parties in actions against the government.

This is particularly meaningful to small businesses that have limited knowledge of the adjudicatory process and are discouraged from countering government actions because of the high cost of litigation. As a safeguard against overzealous enforcement, the bill is critical.

SMALL BUSINESS ADMINISTRATION

The NAM is a member-directed organization. Because the future of the SBA impacts so directly on NAM's small manufacturing members, the Association will survey each small business member regarding specific Administration proposals in an effort to develop a policy representing the broad cross-section of our small manufacturing membership.

However, the National Association of Manufacturers recognizes the need for a strong, effective and independent voice for small business in the councils of government--a voice currently embodied by the Small Business Administration, the Administrator of which sits on the Cabinet Council on Trade.

For more than 30 years, the SBA has stood as the sole government advocate for the small business community. With the rise of a growing entrepreneurial economy, the need for a small business voice is certain to grow as well.

NAM members also recognize the clear responsibility of Congress and the Administration to eliminate wasteful or ineffective programs of limited value to the broad needs of the small business community.

The specific question here, therefore, is "In what form should the voice of small business exist?" In short, will effectiveness be increased by eliminating the Small Business Administration?

SUPERFUND REAUTHORIZATION

Small manufacturers have been unfairly impacted by the application of "joint and several liability" under the current Superfund Program which places upon them site clean-up funding requirements out of proportion to their responsibility or ability to pay.

NAM supports amending the Comprehensive Environmental Response, Compensation, and Liability Act to provide for apportionment of liability based upon the prorated responsibility of responsible parties for existing hazardous waste, where such apportionment is possible.

Apportionment of liability remains the only fair method of determining clean-up responsibility.

ACID RAIN

Various acid rain proposals debated in Congress have sought anywhere from eight to 12 million ton reductions in sulfur dioxide. To achieve these massive reductions, fossil fuel fired utilities and industrial boilers would be forced to install additional abatement equipment. Current law prohibits certain cost-minimizing techniques (like fuel-switching) for meeting emission reduction targets.

Industrial consumers would, in some instances, see their electricity bills rise by as much as 30%. Clearly, many small manufacturers would be unable to afford such increased electricity costs. Additionally, owners of industrial boilers could be required to install expensive control technologies, despite the relatively minor gains in emission reductions.

While supporting accelerated research into alternative sulfur dioxide emission control technologies and the causes and effects of acid rain, NAM opposes acid rain control programs which seek massive sulfur dioxide reductions. Such programs are overly expensive solutions to a problem about which scientific research in in disagreement or which may not treat the cause of problems which do exist.

FREEDOM OF INFORMATION ACT REFORM

With research and development of new technological break-throughs increasingly being conducted by small, entrepreneurial firms, the protection of intellectual propertys is a growing concern of many small manufacturers.

Currently, the FOIA disclosure process is being misused by individuals, including foreign nationals and their agents, to obtain trade secrets and confidential business information for anti-competitive purposes. The FOIA disclosure process is also misused to acquire intellectual property such as research and development results. In the process both patent rights and copyright and trademark privileges are weakened.

The National Association of Manufacturers supports the enactment of procedural reforms that would minimize such misuse, but would not affect the public's legitimate access to information held by the federal government.

The National Association of Manufacturers has developed a comprehensive set of recommendations, and urges adoption of those recommendations. They are:

One. Formal notice to the submitter of an FOIA request for disclosure.

Two. An opportunity for the submitter to object to the impending disclosure.

Three: A stay of disclosure pending agency consideration of the submitter's objections.

Four: The right of the submitter to *de novo* judicial review of an agency decision to disclose.

Five. A requirement that requesters of information file a statement with the agency certifying that they are United States citizens and not acting as the agents of a foreign national.

CONCLUSION

Mr. Chairman, the National Association of Manufacturers commends the committee for providing a forum for the assembly of small business viewpoints on priority issues.

NAM looks forward to working with members of the Committee on Small Business in the realization of efforts designed to continue the expansion of entrepreneurial development and small business growth.

APPENDIX

NAM
National Association
of Manufacturers

ALEXANDER B TROWBRIDGE
President

October 13, 1983

Senator Pete V. Domenici
United States Senate
Washington, DC 20510

Dear Senator Domenici:

The National Association of Manufacturers' (NAM) Fiscal and Monetary Policy Committee welcomes this opportunity to present our views on specific budget policy and procedural reform. In response to your letter of September 24, 1982, we created five task forces to examine some of the specific subjects you highlighted.

Specifically, small working groups met to evaluate progress in the areas of multi-year budgeting, impoundment procedures, entitlements, federal credit activity, and the reconciliation process. Knowledgeable representatives from Congress and the Office of Management and Budget were invited by several of the task forces to present their views on the current situation and to offer their recommendations for reform. As is evident by the following recommendations, many hours of consideration were devoted by our members to this project.

Prior to a discussion of the five specific areas of concern, it is necessary to reiterate an important point emphasized in past testimony. The NAM continues to believe that all federal spending and revenues should be included in the unified budget totals. Past and current projections of budget deficits have fallen short of stating the true amount of federal indebtedness because a portion of federal spending, commonly referred to as off-budget outlays, is never included in budget total estimates. We contend that all off-budget spending should be tranferred on-budget all at once.

With this measure of budgetary control as a base, we present the following broader recommendations:

A. Federal Credit Activity

The National Association of Manufacturers has long recognized the importance and impact of federal credit activity on the national economy. The growth of these programs has contributed to the significant increase in government absorption of available credit. This in turn has made it more difficult for private industry to service its own borrowing requirements, which has resulted in slower rates of capital investment and job creation.

The magnitude of federal credit has been largely overlooked due to a lack of uniform accounting procedures among borrowers and lenders. Comprehensive statistics are essential to determine the full extent of federal credit liability. If the growth of these programs is to be effectively managed, we must begin to address the issue now. The National Association of Manufacturers' Fiscal and Monetary Policy Committee therefore recommends the following:

1. Congress, the Office of Management and Budget (OMB), the Congressional Budget Office (CBO) and the General Accounting Office (GAO) should agree on the definitions for all credit terminology. Currently, major differences exist in the interpretation of these terms. A unified effort would produce the reliable data necessary to assess and establish responsible levels of federal credit activity.

2. Binding limits should be established in the budget resolutions for all federal credit activities. These limits should then be enforced through the congressional authorizations and appropriations processes, primarily through dollar appropriation limitations on credit activity. In order to unify federal spending and credit activities, an equivalent degree of control should be exercised over credit and direct spending programs.

   The language necessary to implement these changes has been developed and was included in the First Concurrent Resolution on the Budget for FY 1983. Similar language should become a standard part of the FY 1984 and subsequent budget resolutions and a part of the Congressional Budget and Impoundment Control Act of 1974.

3. The federal government's total credit liability should be included in both the President's budget and in the reports accompanying all budget resolutions emanating from Congress to highlight the extent of federal involvement in credit markets. In addition, default rates for individual programs should be included in the President's budget to assist in program management and congressional oversight activities.

4. Funds for credit activities should be subject to the same impoundment and reconciliation procedures that are included in the Budget Act for other types of federal funds.

5. As part of its oversight responsibilities, Congress should review all credit programs. Priority for federal funds should be established based on need, program efficiency and cost-effectiveness.

6. Comprehensive statistics on all federal lending activities should be compiled and a periodic analysis of all federal credit programs should be prepared. Development of a credit budget, studies requested by congressional committees, and computer scorekeeping capabilities developed by the Congressional Budget Office have all been helpful in providing the necessary information, but more is needed to establish an accurate assessment of our government's credit obligations.

Many of these recommendations stem from the realization that budgetary treatment of credit practices has been less than that for taxes or direct spending. Credit programs must be subject to the same scrutiny that is afforded by Congress for all federal spending.

B. Multi-Year Budgeting

The NAM supports the purpose and objectives of the Congressional Budget and Impoundment Control Act of 1974. However, the ability of Congress to adhere to the timetable of the Budget Act has declined markedly since the process was initiated, substantially curtailing the ability of Congress to review other legislative issues.

Our Fiscal Policy Committee endorses the concept and benefits of multi-year budgeting. Specifically, the Committee recommends a biennial budget process. The cycle should begin in the first session of each Congress. A budget resolution and all authorization and appropriations bills should be passed in the first year of the cycle, leaving the second year open for oversight and other legislation. In addition, the Fiscal Policy Committee believes that a number of issues related to the budget process need to be addressed and therefore recommends that:

1. A single set of economic assumptions should be agreed upon for all budget proposals by the Congress and the Administration.
2. The first concurrent budget resolution shall be made binding and the mandatory second concurrent budget resolution shall be eliminated.
3. Congress shall have the option to attach reconciliation instructions to concurrent budget resolutions.
4. Any modification of a budget resolution to increase spending shall require a super-majority vote.

C. Impoundment Procedures

We further believe that the impoundment procedures contained in the Congressional Budget and Impoundment Control Act of 1974 are adequate for providing congressional control over the impoundment of funds by the executive branch.

While this executive authority to impound funds may be useful to prevent unnecessary expenditures, it should not be used as a primary tool to reduce federal spending and deficit levels. Policy and program revisions to control the growth of federal spending should be accomplished through the authorization and appropriations processes.

NAM's Fiscal Policy Committee believes that the President should retain the authority to rescind and defer federal expenditures. Therefore, before any changes are made in the Budget Act regarding impoundment procedures, Congress should consider the following recommendations:

1. Line item veto authority should not be granted.
2. The provision of Title X, Section 1001(4) of the Budget Act, known as the "Fourth Disclaimer"[1], should be clarified. This provision attempts to define which federal appropriations are subject to impoundment by the President. The Congress, the Office of Management and Budget (OMB), and the General Accounting Office (GAO) differ in their interpretation of the duration and scope of this provision. We believe that:
   - The Fourth Disclaimer was intended to be a permanent, rather than a temporary, provision of law.

- Only entitlements[2], as narrowly defined by Title IV Section 401(c)(2)(C) of the Budget Act, should not be subject to presidential impoundment.

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[1] Fourth Disclaimer, as defined in the Congressional Budget and Impoundment Control Act, PL 93-344, 31 USC 1401:

Title X -
Section 1001. Nothing contained in the Act, or in any amendments made by this Act, shall be construed as -
(4) superseding any provision of law which requires the obligation of budget authority or the making of outlays thereunder.

[2] Entitlements, as defined in the Budget Act, PL 93-344 USC 1351:

Title IV -
Section 401.
(c) Definitions. -
(2) For purposes of paragraph (1), the term "spending authority" means authority (whether temporary or permanent) -
(C) to make payments (including loans and grants), the budget authority for which is not provided for in advance by appropriations Acts, to any person or government if, under the provisions of the law containing such authority, the United States is obligated to make such payments to persons or governments who meet the requirements established by such law.
Such term does not include authority to insure or guarantee the repayment of indebtedness incurred by another person or government.

D. Entitlement Reform

The NAM has long been concerned with the growth in entitlement programs and their impact on the economy. The "uncontrollable" nature of these programs has hindered numerous efforts aimed at bringing federal spending more in line with revenues.

Our Fiscal Policy Committee believes that entitlement reform should be undertaken to ensure that necessary programs accomplish their objectives in an efficient and cost-effective manner. This entitlement reform can be achieved through existing congressional oversight procedures. However, the procedures must be strengthened to ensure greater congressional accountability.

The business community has its own responsibility in these efforts. Recommendation and implementation of constructive alternatives will assist in reforming entitlement programs. Successful entitlement reform initiatives will lead to the achievement of the common goal of economic stability. Therefore, we recommend the following:

1. The congressional authorization committees should study all entitlement programs within their jurisdiction to determine which programs, if any, should remain as entitlements and which can be reconstituted as regularly authorized and appropriated programs. Pursuant to this task, Congress should determine if the original purpose of the program is still valid; if the eligibility criteria are too broad; and whether benefits are excessive.

2. Congress should not create any new entitlement programs. This would not preclude Congress from creating new programs. Rather, it would ensure congressional control of spending levels that would otherwise be relinquished if the benefits were established as entitlements.

3. Automatic cost-of-living adjustments for entitlement programs should be eliminated. Any periodic adjustments that Congress deems necessary should require a recorded vote.

4. A congressional study should be initiated to evaluate the feasibility of the private sector administration and/or management of federal entitlement programs.

5. Uniform scorekeeping measures should be adopted by both Houses of Congress. The current methods used by the House and Senate differ in the way they assess spending levels, thereby producing misleading comparisons.

E. Reconciliation

NAM's Fiscal and Monetary Policy Committee believes that in order to maintain the integrity of the congressional budget process, enforcement mechanisms, such as reconciliation, are necessary. However, as Congress has expanded its use of reconciliation in the past few years, it has become apparent the process needs to be strengthened and defined in order to help achieve fiscal discipline. Therefore, we recommend the following:

1. The first concurrent budget resolution should be made binding and the mandatory second concurrent budget resolution shall be eliminated. In addition, Congress shall have the option to attach reconciliation instructions to concurrent budget resolutions.

2. The current statutory ten day limit for Congress to complete action on a reconciliation bill or resolution, included in Title III, Section 310(d) of the Congressional Budget and Impoundment Control Act of 1974, is insufficient. The time restraints included in the Budget Act were associated with the need for Congress to adopt a second concurrent budget resolution and reconciliation, if mandated, prior to the beginning of a new fiscal year, October 1. With our recommendation to require only one concurrent budget resolution, these time constraints are mitigated. We look forward to working with Congress to determine a more appropriate timetable for committees to make their recommendations to fulfill reconciliation instructions and for final congressional action on a reconciliation bill or resolution.

3. The Budget Committees and Congress should codify the option to include provisions for reducing spending for both discretionary programs and entitlements in reconciliation instructions.

4. The amount of savings achieved in reconciliation bills shall be measured on the same basis used by the budget resolution which required them.

In conclusion, we would again like to thank you for this opportunity to present our proposals for budget reform. Our members gained a great deal of knowledge and a better understanding of the process while developing these recommendations. This insight will serve as an excellent basis for our future consideration of budgeting procedures.

Sincerely,

AB Trowbridge

ABT/nt

STATEMENT OF
THE NATIONAL FEDERATION OF BUSINESS AND PROFESSIONAL WOMEN'S CLUBS, INC. (BPW/USA)
ON
WOMEN AND SMALL BUSINESS

PRESENTED TO

THE SENATE COMMITTEE ON SMALL BUSINESS

FEBRUARY 6, 1985

The National Federation of Business and Professional Women's Clubs, Inc. (BPW/USA) was founded in 1919 to improve the status of women in the work force. Today, BPW/USA has a membership of over 150,000 women and men, living in all fifty states and the District of Columbia, Puerto Rico and the Virgin Islands. There are over 3,500 BPW/USA organizations with at least one organization in every Congressional District in the United States. Since its establishment over 64 years ago, the objectives of the Federation have remained the same: to promote full participation, equity and economic self-sufficiency for working women.

We appear before you today to testify on women and small business. Women have a unique and very important stake in small business, both as owners and as employees. Over the past decade, the number of women in the paid labor force has increased dramatically. Between 1970 and 1983, the female labor force participation rate increased almost 85 percent, so that women now comprise nearly half (43 percent) of the workforce. Projections indicate that the number of women in the workforce will continue to grow. Girls graduating from high school today can expect to spend at least 30 years in the workforce--whether or not they marry or have children. Small business is a very important avenue into the workforce for women because small businesses tend to employ more women than men. As reported in The State of Small Business: A Report of the President (March 1984), "In 1979, small businesses with fewer than 500 workers were more likely to hire young workers (16- to 24-years-old), women, and elderly workers (65 + years-old). "Small businesses," the report concludes, "therefore, are making it easier for women, older, and younger workers to enter or re-enter the work force. . . "

Paralleling the tremendous increase of women in the work force has been their influx into the entrepreneurial arena. Women are going into business for themselves at a rate five times greater than men. It is estimated that there are three million women business owners in the country today. Between 1977 and 1980, women-owned businesses increased an astounding 33 percent--three times the increase in male-owned businesses (11 percent). Women's share of all nonfarm sole proprietorships increased from 22.6 to 26.1 percent, while men's share declined from 74.3 to 71.2 percent. In addition, the number of jointly-operated businesses declined from 3.1 to 2.7 percent. By 1980 one employed woman in twelve earned part or all of her livelihood as a sole proprietor, contrasted with one man in six.

These women are just now beginning to be identified. Virtually no data was available on women entrepreneurs prior to 1972. And, many experts contend that the data which currently exists does not reflect the entire picture of female entrepreneurship. However, additional data indicates that the number of women-owned businesses has continued to grow by leaps and bounds since 1980. The number of self-employed women (who usually hire no employees and constitute a large portion of sole proprietorships) increased 10 percent between 1980 and 1982. The number of self-employed men, on the other hand, increased only one percent during the same period. These women entrepreneurs have been coined "the new immigrants." "Just as immigrants have looked to business ownership as a way to increase their economic base and power in our society," says Juanita M. Kreps, Former Secretary of Commerce, "women, too, are beginning to use this track."

It is clear that the American dream of owning and operating one's own business is shared by women as well as men. Women are beginning to realize that one of the most important roads to achieving economic parity is via entrepreneurship. Charlotte Taylor, prominent consultant on small business issues and former director of President Carter's Task Force on Women Business Owners, writes in her book, Women and the Business Game:

> What is causing this revival of the entrepreneurial spirit? Part of it is being fired by the smoldering embers of the women's liberation movement. Many women feel that this movement has reached a new stage--a stage where economic power is becoming an important aspect of personal liberation. Money is power and independence and is necessary to achieve spiritual liberation as well.
>
> If the consciousness raising of the 1960s made us realize that archaic sex stereotyping kept us from attaining our fullest potential, the consciousness raising of the 1970s is making us realize that economic freedom and power are fundamental to achieving equality.

While progress has been made--as is evident by the tremendous increase in the number of women-owned businesses--many problems still exist. Women business owners face some of the same problems that all small business owners face. But, as in every area of American life, women face additional barriers that men do not.

Sex Discrimination And Female Entrepreneurship

Overt as well as subtle sex discrimination is still commonplace in every aspect of American life. As Taylor writes: "The subtle societal conditioning that started the moment the pink blanket was put on us and ended when we were pushed into typing and marriage, rather than business courses, creates a double-edged sword. We doubt our own ability to operate in this environment, and others doubt our ability to be competent in it." Initially sex-role stereotyping, a subtle form of sex discrimination, inhibits many women from choosing the option of business ownership or from choosing the education required for such ownership.

When a woman does overcome the initial bias and chooses entrepreneurship, sex discrimination affects every aspect of her business life: she has difficulty building up capital; she is discriminated against when applying for loans; she has difficulty obtaining adequate educational and occupational experience; she is penalized because of her sex in health and disability insurance; and she does not receive her share, proportionate to her numbers, of the lucrative business of government procurement.

The myth that women start businesses for pin money because they are bored housewives is still widespread. However, women are struggling to destroy this myth. "We are tired of the myths that have hampered us for generations. . ." says Taylor, "myths that we can't or shouldn't manage money, that we can't balance checkbooks, that we are poor credit risks, and that we are 'hobbiests' rather than serious businesswomen. All these myths continue to hamper us in the business environment."

Continuing discrimination against women in the work force, and sex-role stereotyping affect women business owners. For example, we know that mid- and upper-level management positions are the training grounds for entrepreneurship. However, large numbers of capable women are kept out of these positions. A recent article in Fortune (March 1984), "Why Women Aren't Getting to the Top of the Corporate Ladder," revealed that in the ten years since U.S. corporations began hiring more than "token numbers" of women, women have not climbed as far as their male counterparts. One study found that of 300 women executives, nearly half felt that being a woman was "the greatest obstacle to their success." "Why?" the article asked. "At one extreme is the charge of blatant sexism, and at the other is the belief that women are unsuitable for the highest managerial jobs: they lack the necessary assertiveness, they don't know how to get along in top management, or they have children and lose interest in--or time for--their careers. Somewhere in between is a surprisingly large group of men and women who see 'discrimination' as the major problem, but who often can't define precisely what they mean."

Thus, we find that attitudes which stereotype professional women and inhibit their success in business are still widespread. For example, a Seattle conference on Women and Business, to take place in June 1984, included many impressive workshops and speakers. However, to our profound dismay, a workshop on "Menstruation, Menopause, Pregnancy and the Professional Woman" was also included. Reflected in this workshop is the erroneous idea that women's normal biological states are somehow a "problem"--that women are hormonally unbalanced, and therefore have difficulty functioning in a professional environment.

Stereotypes of this sort are also responsible for another form of overt discrimination still experienced by businesswomen--exclusion from male-only clubs. Although these clubs argue that they are private social groups, in fact prominent members of the business and political community maintain valuable networks through these clubs. Few single-sex clubs could survive without public support in the form of tax exemptions and deductions, public funding, and tax-deductible corporate support. Yet women, who support these clubs through their tax dollars, are excluded from membership--and often even from appearing in the club. As Judge Ruth Bader Ginsburg has put it, "If women are not offered equal access, if they are not welcomed as full members of the club, they are kept away from a traditional avenue for self-development, economic and political opportunity, and advancement."

Sex discrimination and stereotypes of women also affect their ability to obtain adequate and affordable insurance--an extremely important requirement for any small business owner. In health insurance, coverage is based on male health standards and needs. Female health needs are viewed as non-standard and coverage for them is either excluded or costs more. For example, maternity coverage may be excluded from a policy while coverage for vasectomies is included. When maternity coverage is available it costs more. Small businesses in general are penalized because they employ more women. One woman business owner related this story: After talking to her employees (nearly all women) and finding out what coverage they wanted, she had an agent find her the best insurance for the best price. What she found out, to her dismay, was that she would have to pay more for less coverage because she employed a mostly female work force.

Disability insurance is another area where women are penalized solely on the basis of their sex. Women who work out of their homes are often denied disability coverage, while similarly situated men are insured. And, even when women can get disability coverage, it costs more and the benefits are lower. An informal survey of four companies in the Washington, D.C. area conducted in February, 1983 by BPW/USA found that for a husband and wife (both in their early thirties) starting a business, the rates for the woman were from 17 to 41 percent higher. The dollar differences ranged from $75 per year more for very limited coverage to over $500 per year for lifetime coverage. Therefore, women businessowners find that their insurance dollars buy much less solely because of sex discrimination.

The minority woman, too, faces discrimination on the basis of sex, but she also faces discrimination because of her color. As Dorothy E. Brunson, President of Brunson Communications Inc., said when testifying before the House

Small Business Committee, "I. . . am a rare breed. A successful black woman in the business arena for over 25 years. My experiences have included offenses to both my race and my sex." While we do not have room in this testimony to cover the additional barriers the minority woman faces in entrepreneurship--we are acutely aware of and sensitive to the double discrimination affecting minority women business owners.

Ironically, sex discrimination often provides the impetus for many women to start their own businesses. In a study examining the backgrounds of nearly 500 women business owners throughout the nation, researchers Robert Hisrich and Candida Brush found that men start businesses to achieve independence and make a fortune, while women start businesses out of frustration in their jobs. "These women frequently were stifled knowing they probably couldn't make it up the corporate ladder," Hisrich said. In another interview with women business owners, Taylor found, "Although the reasons why (women) started their businesses varied greatly, many indicated that they felt ownership was the only way that they could find an outlet for their creative intelligence, ambition, and drive. They felt that their sex made them outsiders in the traditional business structures and limited their opportunities for achievement."

Taylor cites the example of a former employee in a brokerage firm, Charlotte Cohen, who kept getting passed over for promotion. "They finally admitted that I'd probably never make partner because I was a woman. I was angry. So I decided that if they wouldn't make me a partner, I'd start my own brokerage business," she said. Another woman told Taylor, "you reach the point where you get sick and tired of arguing with people about why they should treat you equally. So, you decide to just go and show them that you are equal."

Taylor sums up the far-reaching effects of sex discrimination and stereotyping thus:

> In general, women enter the entrepreneurial game with a handicap. We have been raised outside the mainstream of business and finance and have been steered away from the entrepreneurial playing area. Our traditional position in society has kept us both off the playing field and out of the spectator stands. . . We have been inhibited and sometimes prohibited from taking courses and jobs that would have taught us the skills and enabled us to amass the money and the management track record that are the equipment of an entrepreneurial player.

Education--The Door to Entrepreneurship

Equal educational opportunities, providing women and girls with equal access to and information on career choices not based solely on sex, are essential for economic independence. Education has been called "the door to entrepreneurship." Without the education and management training required to own and operate a business, the potential entrepreneur has little hope for success. Mathematics, science, and business courses in high school lead to traditional business majors in college and college business courses pave the path to entrepreneurship. A study by Dun and Bradstreet, Inc. found that over 90 percent of business failures were due to management problems. Whether or not MBAs help (and many experts claim they do), women should at least have equal access to them.

In the SBA's brochure, Women Along Business Lines, one counselor, R. Paul Sprague, chairman of the Warwick Group, Inc., said, "I was astonished at the different level of basic business knowledge between the male and female student. . . It was apparent that our education and social standards prepared males but not females for business ownership."

In the study cited earlier by Hisrich and Brush, the authors found that women entrepreneurs were much less scientifically and technically oriented than male entrepreneurs. The reason, they said, "is that most women entrepreneurs (nearly 70 percent of almost 500 surveyed) have liberal-arts backgrounds, and less than 9 percent have engineering and science backgrounds." As Working Woman (September 1983), who reported the study, concluded, "On the negative side. . . women's weaknesses in technical and scientific areas, in innovation, and in financial expertise could prevent them from taking part in the most promising new business areas."

Thus, subtle forms of educational discrimination continue to exist., Women are discouraged from choosing business courses because they do not lead to "women's work." Business is for men and homemaking is for women. Discrimination of this nature obviously affects women's choices in careers. It affects whether or not a woman will become an entrepreneur and if she does, what type of business she will ultimately own.

One study (American Institute of Research) reported that one-fourth of the women and roughly 15 percent of the men in courses unusual for their sex had been advised against enrolling in such fields. Another 14 percent of the women and 8 percent of the men who entered traditional areas said they had thought about enrolling in nontraditional areas but had rejected the idea after they were discouraged by counselors.

It is essential in this discussion to remember that Title IX of the Education Amendments of 1972 is less than 15 years old, and more importantly, was recently severely restricted by the Supreme Court's Grove City v. Bell decision. In the early seventies women were turned away in much greater numbers than men from most business schools. Quotas were set so that only a limited number of women could attend, while the majority of the seats in business classrooms were reserved for men. In addition, many business schools admitted women only if they had SAT scores 30 or more points higher than entering men.

Since the passage of Title IX, such blatant discrimination is uncommon and gains have been made. The National Advisory Council on Women's Educational Program's Title IX: The Half Full, Half Empty Glass found that "The gains made in degrees awarded to women in customarily male fields between 1972 and 1979 included agriculture: (6% to 27%), business and management (10% to 31%), and law (7% to 40%)." And, "Between 1972 and 1980 there was a 22% increase in the proportion of master's degrees awarded to women. The greatest gains by women in nontraditional areas from 1972 to 1979 were in agriculture (7% to 20%), architecture (15% to 29%) and business and management (4% to 19%)." On the other hand, the report found that "women remained only a small proportion in the important field of engineering (2% to 6%)." In conclusion, the report said, "Although women made gains in agriculture, architecture, business and management, and engineering, the greatest number of women are still receiving degrees in fields that have traditionally attracted the largest numbers of women, such as education and social sciences."

Thus, attitudinal changes are needed to help women seize the opportunities opened to them by Title IX. But those changes can hardly occur without this legal foundation. Ironically, one of the original recommendations of President Carter's Interagency Task Force on Women Business Owners (1978) was "to make vigorous enforcement of Title IX a priority." The recent gutting of Title IX is a tremendous setback for women entrepreneurs as well as all women.

Unequal educational opportunity is one cause of unequal opportunities in the work force, which, in turn, lead to segregation of women-owned businesses. This is an important factor. As one expert stated, "The composition of the work force is crucial to the problem, because it is from the work force that entrepreneurs are born."

Occupational Segregation Affects Women-Owned Businesses

Nearly 70 percent of working women are clustered into the lowest-paying occupations--clerical, service, sales, and unskilled factory jobs. "Of the 441 jobs classified by the Census Bureau in 1980," reported the National Advisory Council on Women's Educational Programs, "only 60 had significant numbers of women; all others were predominantly male."

A recent study entitled "A Woman's Place Is With Other Women: Sex Segregation in Organizations," reported in Working Woman (December 1983), analyzed 20 years of data on 393 California companies. Gathered between 1959 and 1979, the statistics included companies with as few as two employees to those with over 8,000. In addition, the companies in the study represented a wide range of industries, services, and products. The authors, James Baron and William Bielby, measured the amount of sex segregation--defined as the extent to which women and men perform different jobs--in all the companies. Using a scale of zero to 100, with 100 being complete segregation (men and women did not perform the same jobs at any level in the organization), the researchers revealed that more than half of all the companies studied were completely segregated. The median score among the remaining companies was an astounding 84.1, and the 11 largest firms all rated a score of 95 or higher. The authors reported that levels of segregation are "so high and widespread" that "it would be virtually impossible to account for them solely on the basis of skill, experience or choice."

In a follow-up study, the researchers discovered that of the few jobs both women and men held, 85 percent were at the bottom of the career ladders in the companies. They also determined that "segregation at the bottom predetermines segregation at the top." For example, they looked at two entry level positions in a manufacturing company. One job category, "assemblers," consisted of 555 females and no men; the other, "production workers," consisted of 243 males and no women. ~~In the~~ female "assembler" category, there were 10 supervisory positions, while in the male "production worker" category there were 31 supervisory positions--for less workers. Thus, women had significantly fewer opportunities to move up.

Nearly every "how-to" book on business ownership advises the potential entrepreneur to first gain experience in the type of business s/he wishes to own. Thus, segregation in the work force translates into segregation in business ownership. Women-owned businesses remain concentrated in the traditional retail trade and services areas. While women have made modest gains in other types of businesses such as finance, manufacturing and agriculture, roughly 75 percent of women-owned businesses remain heavily concentrated in the miscellaneous retail and personal service areas.

Women entrepreneurs are still channeled into traditionally female business areas like boutiques, second-hand baby clothing businesses, and home catering operations. Women have, historically, been largely excluded from starting businesses in the more lucrative fields such as automobile repair, landscaping, or computer software. One book, Small Business Ideas For Women--And How To Get Started listed these options for potential women entrepreneurs: "flea market store, part-time florist, specialized crafts shop, operating maid or cleaning service, picture framing, selling sweet-smelling things, operating a tourist home, babysitting registry, home catering buisiness, home cooking school, typing service, paper flower making, and shopping guide publisher." The only chapter outlining a business which appeared nontraditional for women was "Planning for a Small Manufacturing Business." In turning to that chapter, we find that manufacturing for women means, "candles, dried flowers, sea-shelled mirrors." While the book is almost ten years old, it is still found in many bibliographies directed toward women business owners. It is also a good example of how business options for women have been limited historically--affecting their choices today.

Further, job segregation also means less pay for women and women-owned businesses. The traditional notions that "women's work" is not worth as much as "men's"—whether it is the same or comparable work--is devastating to women. As Megatrends author John Naisbitt says, "Carpenters make more than nurses because women have always been nurses and men have always been carpenters--and men decide." Women, in all occupational categories, make less than men. This inequity is also found in the businesses women own. While women-owned businesses are segregated into traditional areas, partly because of the experiences working women bring with them, even when their businesses are comparable to male-owned businesses, their return is less. The issue of the

80s—equal pay for work of comparable value--is not confined to individuals, but also surrounds women-owned businesses.

The State of Small Business: A Report to the President stated, "approximately 72 percent of both the male-operated and female-operated construction firms were special trades contractors. However, 45 percent of the female-operated firms were in painting, paper hanging and decorating, but only 11 percent of the male-operated businesses were engaged in these businesses. Almost 23 percent of the male-operated businesses were in carpentering and flooring, and only 5 percent of the female-operated businesses were in these special trades."

"In the service industries," the Report continued, "37 percent of the female-operated businesses were classified as personal services, while only 11 percent of male-operated businesses fit that category. Less than 1 percent of the female-operated businesses were in automotive repair and services, but 8 percent of the male-operated businesses were in that category. In all of the examples, the average net income of male-operated firms exceeded the female average" (emphasis added).

In 1980, the percent of business receipts of female-operated nonfarm sole proprietorships was a mere 8.9 percent, compared to 89.4 percent for male-operated nonfarm sole proprietorships, yet women-owned businesses constitute roughly one-quarter of all small businesses. The average net income for female-operated nonfarm business in 1980 was $2,200, while male-operated nonfarm businesses averaged $7,139.

"These differences in the average net incomes of male- and female-operated businesses raise the question of how and to what extent individual attributes of females in educational attainment and job skills affect their opportunities for business," the Report concludes (emphasis added). But given women's disadvantages in education, employment and business competition, this statement is naive at best. While educational attainment and job skills certainly affect any entrepreneur's opportunities for success in business, sex discrimination is the major factor hampering businesswomen. Women's work--whether it be their own or their work for someone else, whether it is identical or comparable to men's work--is simply not worth as much in the eyes of society. It is outrageous to imply that women's "individual attributes" account for the overwhelming inequities in female- and male-owned businesses.

Capital and Credit

Women and their businesses, as we have seen, make less than men and their businesses. This gap has remained constant for over a decade despite vigorous attempts to narrow it. Such inequities seriously affect the woman entrepreneur's ability to build adequate startup capital to open a business, as well as obtain loans for expansion. A number of factors combine to make women look like poor credit risks. Along with occupational segregation and the accompanying wage discrimination discussed above, other factors negatively affect women's attempts to obtain adequate business financing.

Because of long established and continuing social patterns, women more often interrupt their careers to tend to traditional family matters such as raising children or caring for disabled adults. Also, as pointed out earlier, women are less likely to have the "hands-on" business experience which many lenders look for before granting a business loan. And, because women-owned businesses are clustered in retail and service industries--industries which are less profitable than manufacturing and high tech--lenders are less likely to grant credit.

Financial institutions are generally conservative. They tend to favor large loans to well-established companies over small loans to smaller, newer enterprises. A bank would rather make one $100,000 loan to a secure, profitable business than ten $10,000 loans to new, small and less lucrative enterprises--exactly those enterprises which are usually women-owned. Moreover, in a time of economic downturn, or tight money, financial institutions become even more wary of lending to small businesses--a situation which more negatively affects women.

In The Annual Report to the President (June 1980), the Interagency Committee on Women's Business Enterprise stated, "The most formidable barrier to women's efforts to establish businesses of their own continues to be lack of access to traditional sources of credit and capital. Banks have been slow to perceive women as a profitable target market. Because of their low income status relative to men, credit worthiness is often difficult for women to establish when standard measures such as collateral and income form the basis for judging. The very small size of many women's enterprises both in receipts as well as number of employees hinders their ability to focus on expansion."

Realizing these problems, the Small Business Administration initiated a mini-loan program exclusively for women entrepreneurs in late 1979. The SBA program, designed to assist women whose capital needs for starting or expanding a business were $20,000 or less, received 150,000 requests for mini-loan information almost immediately. During the first six months of FY 1980, the SBA approved almost 900 loans for $13.9 million--with roughly half granted to existing women-owned businesses and half to new businesses.

Unfortunately, this successful program was discontinued in the early years of the current administration. Women-owned businesses and women entrepreneurs must once again compete with larger, well-established and usually male-owned businesses for credit from conservative lending institutions.

While all small business owners face difficulty obtaining business loans, sex discrimination and sex-role stereotyping heighten the problem for women. Many financial institutions and individual lenders still hold discriminatory attitudes toward women seeking business credit--and many practice those attitudes. Despite efforts on the part of women's organizations to educate financial institutions and individual lenders, many continue to be insensitive to the needs of women business owners.

A 1977 Census Bureau Study, Selected Characteristics of Women-Owned Businesses, reported that more than 60 percent of women-owned businesses were financed from the owner's own savings, and over 80 percent were started with no capital or less than $10,000. Another survey found that almost 70 percent of women-owned firms were capitalized by relatives, friends or the owners themselves; another study revealed that over 30 percent of women who had been turned down for bank credit felt the denial was at least partially due to discrimination.

Authors of Be Your Own Boss: A Woman's Guide to Planning and Running Her Own Business, Barbara S. McCaslin and Patricia P. McNamara interviewed over 300 California women business owners. Their research revealed that "Although almost two-fifths of the women said they had spoken with a banker before starting their businesses, only 33 women said they had received commercial loans from a bank" (33 out of over 300, not 33 percent). All of the women interviewed, according to the authors, encountered discriminatory attitudes, "some more than others." One woman reported, "Women are often discriminated against when they seek loans. It's subtle, applications are scrutinized and evaluated more carefully and conservatively, and they're held up. The whole process tends to take longer." Bankers contend that the high rejection rate of female applicants is due to "poorly prepared loan applications, insufficient business experience and inadequate knowledge of market conditions," rather than sex discrimination.

For the minority woman, of course, racism worsens the situation. Research conducted by the National Association of Bank Women (NABW) revealed that "Black women entrepreneurs indicated they had experienced what was perceived to be discrimination, or at least a significant lack of receptiveness, in their attempts to seek financing. Several noted that the combination of being female and black meant they had to push significantly longer and harder to achieve their goals." One black woman, owner of a pharmaceutical manufacturing firm, experienced 12 "nos" before she was granted an expansion loan. Based on their research, NABW concluded "Minority women entrepreneurs may, and often do, face a series of challenges in seeking financing that are beyond those that their non-minority counterparts face. More than adequate preparation of a business plan, etc. will be required when minority women seek financing."

Women don't want special opportunities; they want equal opportunities. Lenders must rid themselves of sex-bias and be sensitive to the needs of female entrepreneurs. Commercial lending officer and author of 101 Tips For Women Entrepreneurs, Don Alexander says, "In the final analysis, possibly the deciding factor in many cases resulting in the granting of a loan is what is generally called the banker's 'gut feeling' toward the borrower." If the banker tends to view business as outside the realm of "women's work," his/her "gut feeling" will probably be to turn down the loan to the woman entrepreneur.

One banker told Alexander, "I have to plead guilty of sometimes having a biased feeling toward women loan applicants. On first impression, it is mainly a feeling of apprehension that the lady sitting at my desk probably has not had prior experience operating a business, is not fully prepared with a well-thought-out business plan, and has not done her homework and research. She probably does not have the necessary capital to get the business off the ground and may take up an excessive amount of my time to present her request." With this amount of pre-determined sex-bias, it is amazing that any women are granted loans. Of course, not all bankers hold such negative attitudes, and even this one relented with, "I am always delighted when I am proven wrong. Come to think of it, this seems to be happening more and more lately."

Obviously a lot of women seeking business credit find that they have to meet higher standards than men in equivalent situations. Many women also feel that they are refused credit simply because of their sex or marital status. Some women, for example, have reported that they have been denied credit because of the credit rating of their former spouses. If a woman thinks she has been discriminated against in commercial lending, however, she has no practical recourse. The Equal Credit Opportunity Act of 1974 (ECOA)--protection which women worked so hard to obtain--generally does not apply to commercial credit transactions.

The ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, marital status, age, receipt of public assistance, or the exercise of rights under the Consumer Credit Protection Act. While the ECOA does bar sex discrimination in credit dealings, it exempts business credit from many of the law's requirements. For one thing, creditors are allowed to request information concerning the commercial credit applicants' marital status. Secondly, creditors are not required to retain records relating to the commercial credit application unless the applicant requests retention. And finally, creditors are not required to provide written reasons for denying commercial credit or to automatically disclose an applicant's right to request a statement outlining the reasons credit was denied unless the applicant requests such notice within 30 days of being turned down. It becomes clear upon examination that with the omission of these "procedural" safeguards, the substantive provisions of nondiscrimination in the ECOA are unenforceable in business transactions.

The Federal Reserve Board reviewed and withdrew amendments that would have corrected these problems, citing cost, lack of evidence of discrimination, and a belief that women already know that they must request information. Studies, however, have shown that the costs of developing a notice informing applicants of their right to request the reasons for credit denial would cost only pennies--pennies which could be charged to the applicant. If women already know about their rights under ECOA, providing written notice of this right will not increase the requests for information. But if this is not the case--as many authorities believe--failure to require notification keeps women and other protected persons at the mercy of the lender's "gut feeling."

Government Procurement Opportunities

Another hindrance to the survival and success of women-owned businesses is their virtual exclusion from federal procurement. The federal government is probably the most stable, lucrative customer in America today--buying more than $100 billion worth of nearly every kind of good and service available each year. Yet, female-operated firms accounted for only four-tenths of one percent of the total award value of Fiscal Year 1982 federal prime contracts over $10,000 and merely 2.7 percent of the value awarded to all small businesses. It is important to keep in mind that about one-fourth of all small businesses are women-owned.

Women have been nearly locked out of most opportunities in government contracting. Much has been, again, blamed on women themselves--their lack of knowledge and experience, or the type of service or product they are most likely to produce. Bidding for government contracts is a competitive, demanding business which requires adequate working capital, marketing expertise and a thorough knowledge of contracting practices and opportunities. In addition, we are told that women are not involved in the sectors of industry in which government does contracting. An analysis of this situation, however, reveals that discrimination and the absence of strong federal initiatives establishing a greater commitment to women-owned businesses are at the heart of the problem.

Consider the following example: A Washington Star article (September 1980) reported that Karen Hastie Williams, administrator of the Office of Federal Procurement Policy, was told by the head of procurement at the Department of Defense that doing business with women-owned businesses was, essentially, a threat to the nation's security. Robert Trimble, acting deputy undersecretary for acquisition policy and author of the letter wrote, "Providing for the country's defense is our primary mission. . . As indicated above, I have reached the conclusion that the continued imposition of social programs on the procurement process is adversely affecting our ability to fulfill this objective." "Never mind," the Star reported, "that a good 30 percent of Defense's multi-billion dollar procurement budget goes for such things as uniforms, food, laundry and dry-cleaning equipment, liquor, draperies, musical instruments, textiles, signs and advertising displays, toiletry articles, catering services and the like."

One study, reported in the SBA's Selected Abstracts of Completed Research Studies revealed that procurement personnel resist set-asides to small businesses because of a general belief that "social objectives should not be achieved through the procurement process." Yet, experts say that women who operate businesses which are eligible for government contracts are prevented from obtaining the contracts by the general attitude of agency personnel, and that "arbitrariness" is often involved in the granting of government contracts. Several small businesses who were interviewed revealed that "the most important factor limiting bidding on contracts was 'some organizations have an inside track'"—a track women obviously do not have. As one woman said, "women are usually not in these old-boy information networks."

The barriers that now exist for women business owners and potential entrepreneurs will not be eliminated overnight. Probably the most important statement that could be made is one that Margaret Heckler, Secretary of Health and Human Services, made when she testified in hearings on the status of women's business enterprise in 1980: "The burden falls equally on both the public and private sector, but. . . nothing will happen in the private sector unless the government takes the lead."

As the Washington Star article mentioned above stated, "The bright glow of promise which surrounded the Carter administration's much-heralded women-in-business program has long since faded." It is telling that most of the problems outlined in that administration's report, The Bottom Line: Unequal Enterprise in America, released in June, 1978 remain.

We are encouraged by recent federal, congressional and political party interest in women entrepreneurs. As Virginia Littlejohn, President of Littlejohn and Johnson, Inc. and President of the Capital Area Chapter of the National Association of Women Business Owners wrote, "This activity by the parties indicates that Washington policymakers are finally becoming aware of the enormous potential contribution of small business to long-term economic recovery, particularly to job creation. The contributions women business owners can make to this effort are substantial."

Recommendations

However, before women have the opportunity to make these contributions, much needs to be done.

- First, reliable data on women-owned businesses must be available. As Littlejohn reported in recent testimony before the House Small Business Committee, "the most recent report. . .draws on essentially the same stale and pitifully inadequate statistics we have had in the last several years concerning the number and gross annual receipts of women-owned firms."

- Equal educational opportunities are essential to women's ability to successfully own and operate businesses. The elimination of sex bias in education holds the key to ending discrimination against women. Every effort Congress can make in this area would be helpful. Included is restoration and vigorous enforcement of Title IX. Further, reauthorization of and increased funding for the Women's Educational Equity Act would be extremely beneficial. This program has been very effective in eliminating educational inequities, particularly for minority and disabled women. We also recommend reauthorization of the Vocational Education Act, legislation which has helped to implement sex equity for women and girls in vocational education. Outreach programs providing management and technical assistance for women have also been extremely successful--they must be continued and enhanced.

- We strongly encourage that opportunities for women in "nontraditional areas" be expanded so that women can open businesses in all fields--including the most lucrative ones. Occupational segregation must be eliminated so that women can open businesses of their choice and have equal opportunities for higher returns on their investments. Implementation of equal pay for work of comparable value is imperative if women are to be able to start and expand businesses of their own in all fields.

- Equal access to capital and credit is, again, essential. The Equal Credit Opportunity Act of 1974 has done much to eliminate sex discrimination in consumer credit without adversely affecting lending institutions. Why is this protection missing in the very important area of business credit? We think the ECOA provisions should be extended to business credit so that women entrepreneurs have some tool with which to fight discrimination. We also suggest the continuation and strengthening of outreach programs to assist women in expanding their access to capital and credit. The National Association of Bank Women are to be commended for their efforts in this area. In addition, lender sensitivity to the needs of women-owned businesses would obviously be helpful.

- Legislation to eliminate all forms of discrimination in insurance should be enacted.

- Federal procurement opportunities for women must be enhanced. The development of mechanisms and incentives is imperative if women are to partake of their fair share of the lucrative government procurement business. Four-tenths of one percent is a pitiful level of participation when we know that women own at least one-quarter of all small businesses. Numerical goals to dramatically increase the number of women-owned firms qualifying for federal contracts must be established and strictly enforced. We applaud Elizabeth Dole, Secretary of Transportation, for her strong commitment to women entrepreneurs by increasing their opportunities to qualify for contracts under the National Surface Transportation Act. However, women desperately need such leadership and follow-through from more than one policymaker.

Women have for too long been excluded from the full fruits of entrepreneurship because of legal and social barriers. We must vigorously support all efforts to ensure that more capable women can fulfill the American dream of owning their own business. As Rep. Geraldine Ferraro (D-NY) recently stated, "the solution to problems faced by women in business is to watchdog what is happening in Washington and to recognize that one woman's problem is every woman's problem." We would further state that what is every woman's problem is America's problem.

STATEMENT BY
THE
NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION
SUBMITTED TO
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
FEBRUARY 21, 1985

I. INTRODUCTION 1

II. MACHINE TOOL INDUSTRY LEGISLATIVE PRIORITIES 5

- A. Tax Simplification 5
- B. Product Liability Reform 6
- C. Eximbank 7
- D. R & D Tax Credit 9
- E. Export Licensing 10
- F. SBA Programs 12
- G. Trade Remedy Legislation 13
- H. IRS Recordkeeping Requirements for Company Vehicles and Fringe Benefits 13

III. CONCLUSION 15

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I. INTRODUCTION

The National Machine Tool Builders Association, (NMTBA) is a trade association representing more than 300 member companies which account for approximately 85 percent of machine tool production in the United States. The Committee will be interested to note that the vast majority of U. S. machine tool establishments employ fewer than 100 persons.

NMTBA appreciates this opportunity to present its legislative priorities to the Committee. We share the Committee's view that a healthy small business network contributes significantly to a balanced and prosperous American economy.

We will begin our statement with a brief update on the machine tool industry's competitive outlook.

Throughout 1983, while the economy as a whole experienced robust growth, the machine tool industry failed to share in the cyclical expansion. In fact, when measured in terms of shipments, 1983 was a disastrous year. Deliveries of new machine tools totaled just $1.8 billion, slightly more than half the level of the previous year and only about one-third the 1981 total. Although orders were up, the increase was a meager 13% over the extremely low level of 1982.

However, the machine tool market appeared to be gaining momentum during 1984. New orders for the year were 72%

ahead of comparable 1983 figures. Shipments, reflecting the relatively slow pace of 1983 orders, were up 23% over 1983 levels. Certainly the fact that the industry has begun to turn around is a hopeful sign, as are recent surveys indicating that manufacturers plan to continue the boost in their capital spending during 1985.[1]

Certainly, this is positive news. It must be recognized, however, that to date, a major portion of the increase in 1983 and 1984 orders is due to the surge in automobile manufacturing and related industries. The machine tool industry's auto-related orders, while welcomed, are limited primarily to four product lines: transfer machines, large presses, certain grinding machines and gear-making machinery.

Thus, while these signs are encouraging, they by no means signal a full-fledged return to prosperity for the entire industry. Most machine tool builders continue to remain in a state of severe financial strain due to the modest recovery in shipments. Getting through this cash-flow crisis is the industry's immediate concern. And though we are headed in the right direction, 1985 appears to be another tough year for U. S. machine tool builders.

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[1] However, the U. S. Department of Treasury's recent proposal to eliminate accelerated capital cost recovery and the investment tax credit would, if enacted, have a disastrous impact on the rate of capital investments. See the discussion which begins on p. 5.

A major factor complicating the prospects for recovery is the spectre of further import inroads into the American machine tool market. Based on current trends, we estimate that imports, measured by value, will account for a staggering 38% of 1984 domestic machine tool consumption. Unfortunately, imports have shown every sign of maintaining or increasing this market share as the recovery unfolds in 1985.

The Committee will be especially interested to note that the most vulnerable domestic markets continue to be numerically controlled machining centers and turning machines -- two "high tech" and defense-sensitive machine tools which are vital components of flexible manufacturing systems and "factories of the future" that we are all hearing so much about.

It is because of the threat of import dominance in the machine tool market, the industrial backbone of American manufacturing and America's defense industries, that early in 1983 the NMTBA filed a petition for import relief with the Secretary of Commerce under Section 232 of the Trade Act of 1962, the National Security Clause. While the Association has long been a proponent of free trade and has one of the most active international trade promotion efforts in the trade association field, we cannot stand idly by while key segments of the American machine tool industry are decimated by targeted sales of foreign machine tools -- and, more importantly, while the national security of the United States is imperiled by the transfer of machine tool productive capacity to the Far East. Frequently assisted by subsidies and a variety of preferential programs sponsored by their respective governments, foreign builders have come to dominate certain key sectors of the domestic machine tool market, a fact we find blatantly inconsistent with our vital national interests.

The significance of the threat of machine tool imports goes far beyond the welfare of just the domestic machine tool building industry. If the industry is allowed to be overwhelmed by foreign products, the innovations and new manufacturing process technology that it provides America's manufacturing industries will be lost. Foreign firms will then have the upper hand in the development of new technology and will be the leaders in the drive to more efficient, lower-cost production of manufactured goods. The loss of America's machine tool building capability could well signal the beginning the the decline for all of America's metalworking manufacturing industries.

The Commerce Department submitted a reportedly favorable recommendation for action on the petition to the President on February 28, 1984. Thus, for the past year, the fate of the industry's future has rested squarely in the Oval Office. Yet despite overwhelming bipartisan support from Congress for a favorable ruling, the petition remains hung up in the National Security Council and the President still has not acted.

With almost two years having passed since the initial filing, most NMTBA members, aware that a timely resolution is not forthcoming, have, out of necessity, moved ahead with investment decisions that could no longer be postponed. Some companies decided to completely withdraw from the machine tool business; others are transferring what is left of their operations offshore. The end result is, of course, an unmistakable erosion of the very core of this nation's productive capacity.

II. MACHINE TOOL INDUSTRY LEGISLATIVE PRIORITIES

There are a number of pending federal legislative initiatives which bear substantially upon the industry's continued competitiveness. These initiatives are summarized below.

A. Tax Simplification

The Treasury Department's tax simplification plan, unveiled late last year, calls for elimination of both the depreciation reform (ACRS) achieved in 1981 (and watered down in 1982) and repeal of the 10% investment tax credit (ITC). According to Treasury, the "trade-off" for elimination of depreciation reform and the investment tax credit is a reduction in the corporate tax rate from the current 46% to 33%. Thus, Treasury argues, most corporate taxpayers would be better off under its proposal. However, most manufacturing industries would be worse off.

Machine tools could be depreciated at a rate of 12% per year over a 17 year period under Treasury's Real Cost Recovery System (RCRS). The annual basis, against which the 12% depreciation rate would be applied, would be adjusted upward each year to reflect inflation.

According to our calculations (assuming a 5% inflation rate) a company could recover 6% of its investment in a new machine tool during the first 2 years. This compares with 28% under ACRS.

The following chart shows the tax liability of 2 corporations under current law and under the Treasury proposal. Both corporations have $200,000 in retained earnings. Corporation A uses the $200,000 to buy new machine tools. Corporation B distributes the entire $200,000 to its shareholders in the form of dividends.

	Tax Liability	
	Current Law	Treasury Proposal
Corporation A	$55,400	$62,600
Corporation B	$92,000	$33,300

The policy considerations which gave rise to this result are indeed ominous for basic industries attempting to modernize in order to become more competitive in world markets. The improved cash flow provided by the "front loading" involved in ACRS and the ITC is extraordinarily important to purchasers of capital equipment. Because NMTBA believes that elimination of ACRS and the 10% ITC is too high a price to pay for reduced corporate rates, we emphatically oppose the Treasury Department's RCRS proposal.

B. Product Liability Reform

An area of overriding concern to the machine tool industry -- especially small metal-forming companies -- is the problem of product liability. Currently, product liability laws vary -- sometimes widely -- from state to state. Because the products of most companies are distributed nationwide, it is virtually impossible to determine the standards by which those products will be evaluated. This uncertainty in the law has led to substantial increases in product liability insurance rates and legal fees -- costs which must ultimately be reflected in the price of our members' products. Product liability thus works against the industry's ability to remain competitive in the international marketplace, since our foreign competitors are subject to product liability costs which are significantly lower than ours. Unfortunately, due to the interstate commerce nature of this problem, state action will not resolve the dilemma. Approximately 31 state legislatures have passed some form of product liability statute. But these are limited in scope and most importantly, no two state statutes are exactly alike.

That is why there is an urgent need for a uniform product liability law enacted at the federal level. NMTBA strongly supports the Product Liability Act (S. 100), introduced by Senator Bob Kasten (R-WI) and currently pending before the Senate Commerce Committee.

C. Eximbank

The Administration proposes to terminate the Bank's direct loan program and to reduce its loan guarantee and insurance programs. Eximbank's direct loan programs represent this nation's primary instrument for neutralizing predatory trade financing practices utilized by certain of our foreign competitors. By offering export credit terms comparable to those available to foreign competition, a healthy Eximbank direct loan program will improve significantly the ability of U.S. exporters to compete effectively in world markets. NMTBA therefore strongly opposes the elimination of direct loans, believing that necessary spending reductions can be achieved without imposing such a drastic measure.

In addition, although the Bank recently has undertaken an effort to be more responsive to the needs and concerns of small business exporters, NMTBA believes that none of the Bank's existing small business programs adequately addresses the difficulties confronted by exporters seeking to finance transactions which involve amounts less than $250,000.

The small business exporter frequently deals with sales involving amounts well under $250,000 -- unit sales typically range from $5,000 to $150,000. However, local U.S. banks -- even those participating in Exim programs -- generally are reluctant to process loans for amounts below $250,000.

As a result, the small U.S. exporter, who almost always solicits overseas sales through a distributor, is saddled with a substantial disadvantage in the international marketplace. Once the distributor locates a potential overseas customer, he is frequently unable to offer that customer favorable terms. The distributor for the U.S. supplier is forced to require a cash transaction in the form of an irrevocable letter of credit, payable at time of shipment. The customer often is, understandably, unable (or unwilling) to meet these terms and must therefore turn to suppliers from other countries who offer more flexible financing packages. Distributors, who also represent the industry's foreign competitors, stand in a ready capacity to assist these customers. The American exporter's loss thus becomes his competitor's gain.

In order to remain a viable force in world markets, American manufacturers competing for overseas business must be in a position to offer methods of favorable financing. The availability of such methods will encourage distributors to pursue and promote the sale of American products, thereby enhancing the position of American exporters within the foreign distribution network -- a network which is crucial to small business export sales.

In order to assist the Bank in addressing this deficiency, NMTBA recently initiated discussions with Exim officials to consider the feasibility of establishing a pilot program under which credit-worthy machine tool builders would agree to process their sales through a single bank selected by the industry and approved by Exim. This concept, by ensuring a sufficient volume of business, makes it financially worthwhile for a bank to undertake smaller transactions. In addition, specific markets approved for Exim credits would be targeted by the builders with the option to expand if the pilot program proves feasible. NMTBA would, of course, assist in the development and implementation of the pilot program.

Although our discussions are in the early stages, we are encouraged by Exim's favorable response. We will be happy to keep the Committee apprised of the proposal's progress.

D. R & D Tax Credit

International competitiveness is inexorably linked to innovation. Taking into account the rapid advances in technology that are affecting the machine tool industry and its customers, it is not an exaggeration to say that expenditures for research and development are the lifeblood of the machine tool business.

The 25% R & D tax credit, enacted as part of 1981's historic Economic Recovery Tax Act, is scheduled to expire on December 31, 1985. The credit represents an especially significant resource for small businesses, which often have limited funds to invest in new technology. NMTBA strongly supports recently introduced legislation which eliminates the current sunset provision under which the 25% R & D tax credit is due to expire, thereby making the credit permanent; revises the definition of expenditures which are eligible for the credit, making the credit available to newly formed corporations and R & D joint ventures; creates a new incentive for corporate payments to universities and other qualified non-profit, tax-exempt organizations for basic research; and allows an enhanced deduction for corporate donations of scientific and technical equipment and computer software to universities and other qualified institutions.

E. Export Licensing

Unnecessarily restrictive federal export control policies have severely hindered the competitiveness of U.S. exporters. Unfortunately, after 18 months of legislative effort and attempts at compromise, the 98th Congress failed to adopt a re-authorization of the Export Administration Act (EAA), which provides legislative authority for the imposition of export controls. This means that, until Congress makes another attempt at re-authorization, the Administration must exercise its export control authority under the Emergency International Economic Powers Act, which is currently being challenged in the courts.

Congressional re-authorization of the EAA failed last year due to the injection of the important, but essentially unrelated, issue of whether to impose economic sanctions against South Africa. Ultimately, the House and Senate were unable to agree upon the form that sanctions against the government of South Africa should take. The failed compromise is especially frustrating, since the South Africa sanctions issue is tangential to the central core of the export control legislation.

Congress came close to adopting the following, NMTBA-supported package, which reflected agreements earlier negotiated between House and Senate conferees. The package provided for these national security control reforms: (1) more favorable assessment of foreign availability; (2) elimination of export controls on spare parts; (3) elimination of controls on most shipments to COCOM destinations; (4) elimination of some individual license requirements for technology transfers to foreign subsidiaries or licensees. In addition, the bill included the following foreign policy control reforms: (1) contract sanctity (the prohibition of retroactive application of foreign policy controls to existing contracts); and (2) requirements that lack of foreign availability and certain other factors be present before new foreign policy controls are imposed.

Legislation which includes these reforms (and which does not address South African sanctions) has been re-introduced in the 99th Congress. We remain hopeful that an early resolution of the export control issue will result in the re-authorization of a more realistic EAA.

F. SBA Programs

Congress' recent modification of the SBA 503 loan guarantee program[2] resulted in a financing mechanism which better accommodates the needs of the machine tool industry. However, as the Committee is undoubtedly aware, the Administration's proposal to abolish the SBA contemplates that all SBA direct loan and loan guarantee programs be eliminated outright rather than transferred to other federal agencies. NMTBA therefore urges the Committee to ensure that the 503 program survives, independent of whatever action ultimately befalls SBA. We also hope that the Committee will agree with NMTBA's observation that job creation guidelines should be realistic. It should be recognized that, in addition to job creation, increased productivity per worker and job retention are also legitimate objectives.

The Administration's SBA proposal apparently does not contemplate elimination of the Small Business Innovative Research (SBIR) program. Instead, administration of the program reportedly would be shifted to the National Science Foundation and other federal agencies. NMTBA believes that the SBIR program -- a valuable resource to small business R & D -- should survive its SBA transition intact.

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[2] The 503 program currently offers financing for up to 40 percent of project costs on a subordinated mortgage basis. "Project costs" include the cost of land and building, construction or renovation of buildings, leasehold improvements and purchase of machinery and equipment, including some furniture and fixtures. The source of 503 funds is the sale of federal debentures, which SBA fully guarantees in the event of default. The program is primarily intended to promote job creation.

Funding for the 503 program was increased by $100 million last year, bringing the FY '85 level to $450 million. And we understand that revised regulations, soon to be published by SBA, will propose a shortened minimum loan term of ten years.

G. Trade Remedy Legislation

Unfair trade practices by the industry's foreign competitors account largely for the lack of a level "playing field" in the international marketplace. Consequently NMTBA supports vigorous enforcement of U. S. dumping laws as well as simplification of procedures by which domestic manufacturers may obtain relief from dumping practices, targeting, illegal import subsidies and other methods of unfair competition.

Congress last year adopted a modest reform of trade remedy laws together with re-authorization of easier access to U. S. markets by less developed countries and stronger requirements that foreign countries provide better access to U. S. products. We are hopeful that Congress will renew efforts to enact strong anti-targeting legislation in 1985.

H. IRS Recordkeeping Requirements for Company Vehicles and Fringe Benefits

The Tax Reform Act of 1984 created special rules for retaining the tax benefits of company vehicle ownership and collecting taxes on the personal use of company vehicles by employees. The rules are part of new Internal Revenue Code provisions which limit investment tax credits (ITC) and accelerated cost recovery deductions (ACRS) for so-called items of listed mixed-use property (Property subject to both business and personal use) and new rules on the taxation of employee fringe benefits.

The new tax law's statutory provisions have been implemented in two sets of temporary proposed income tax regulations. Although the new regulations do not change the principles of non-cash fringe benefit taxation, they do provide specific instruction on how to comply in reporting fringe benefits. Likewise, existing principles for determining personal vs. business use of vehicles based on whether they are employed for the convenience of employers remain unchanged. However, more demanding recordkeeping requirements are now imposed.

The combination of these two sets of regulations subjects employers and employees to dramatically increased recordkeeping requirements. The most burdensome of these recordkeeping requirements is the maintenance of mileage logs for virtually every type of company vehicle. All cars, trucks, vans, and other means of transportation, are subject to the recordkeeping requirements even though the vehicle may have been fully depreciated or expensed in a prior year. Records must be maintained for at least six years from the date of acquisition of the vehicle.

While NMTBA believes that tax laws should be vigorously enforced, burdensome regulations such as these -- particularly onerous and costly to small businesses -- are counter-productive and ultimately lessen business productivity.

The Internal Revenue Service, under heavy pressure from Congress and protests from taxpayers, stated January 25th that it will ease the requirements of the above regulations on recordkeeping on business use of automobiles. The revised regulations, when they are released, must be carefully reviewed to determine whether business concerns have been adequately addressed. In this regard, we urge the Committee to closely monitor this situation.

III. CONCLUSION

NMTBA appreciates the opportunity to apprise the Committee of its federal legislative agenda. Should any follow-up to this statement be required, NMTBA will be happy to further assist in the Committee's assessment of the needs and concerns of the machine tool industry.

PROCUREMENT ROUND TABLE
1001 North Highland Street, Suite 201
Arlington, Virginia 22201
(703) 528-0072

February 15, 1985

The Honorable Lowell P. Weicker, Jr.
Chairman, Small Business Committee
United States Senate

Dear Senator Weicker:

I am pleased to respond on behalf of the Procurement Round Table (PRT) to the invitation to make suggestions for your Committee's agenda for this session of Congress. For your information, the PRT is a nonprofit organization composed entirely of individuals who have volunteered their extensive knowledge about federal procurement, based on their experiences in government, industry, and academia, to assist in improving the federal procurement process.

Attached is a short description of topics the Committee may wish to consider. While some of the topics are not specifically small business oriented, they can and do impact small businesses and their participation in federal procurement. Others involve consideration of small business preferences in relation to Congressional mandates for full and open competition and the effects on the procurement process overall, e.g., the resulting dual standard contracting officials are faced with.

The PRT would be pleased to discuss any of the attached topics with you or the Committee staff.

Sincerely,

Elmer B. Staats

Elmer B. Staats
Chairman

Attachment

ATTACHMENT

TOPICS FOR SENATE SMALL BUSINESS AGENDA

- Simplification of small purchase procedures, including an increase in the threshold, development of a "paperless" system for small purchases, and increasing the dollar level for impressed funds.

- Reducing the socio-economic requirements imposed on small business contractors and subcontractors.

- Providing incentives to contractors and first tier subcontractors to utilize small businesses. This might include tax incentives such as South Carolina has.

- Extending multi-year contract authority to civilian agencies.

- Simplifying the Federal Acquisition Regulations (FAR), including reduction in the agency supplements; and, perhaps, preparing a separate FAR chapter covering all requirements and contract provisions for contracts with small businesses.

- Assuring that OFPP is retained as a statutory policy body with more specific authority to enhance small business programs with adequate regulatory authority, and resources. This might include authority to adjust the threshold for small purchases and application of specified socio-economic requirements.

- Review OFPP test programs to assure full consideration of small business.

- Review agency implementation of the Prompt Payment Act, its impact on small business, and conformance of implementation with the Act's intent.

- Removal of the Contract Disputes Act certification requirement for claims in excess of $50,000.

- Revision of the Equal Access to Justice Act with respect to payment of attorney fees.

- Consider alternatives to mandatory small business set asides and size standards.

- Indemnification (above reasonable insurance) of contractors, subcontractors, and supplies against third party liability for non-commercial products and services sold to federal agencies.

- Increasing the professional capability of the Government agencies' work forces handling procurement and the small business programs. This might include special training of contracting officers and program people on small business requirements and objectives.

- Research to determine the most successful and effective techniques for implementing socio-economic programs through the procurement process. This could include documentation of those programs which have not proved out, and how to avoid similar results in the future.

- Review Congressional edicts which restrict contracting out and their effects on small business opportunities to obtain contracts.

- Examine small business production of spare parts.

NATIONAL-AMERICAN WHOLESALE GROCERS' ASSOCIATION

DATE: February 6, 1985

STATEMENT OF: Denis R. Zegar
Vice President,
Government Services

BEFORE THE: Senate Committee on Small Business

SUBJECT: Legislative Priorities for the
99th Congress

Mr. Chairman and Members of the Committee on Small Business:

My name is Denis R. Zegar and I am Vice President for Government Services of the National-American Wholesale Grocers' Association, commonly referred to as "NAWGA." I very much welcome this opportunity to submit this written statement for the official record concerning the Committee's efforts to establish an agenda for the 99th Congress.

By way of background, NAWGA is a national non-profit trade association which represents nearly 400 independent wholesale grocers and foodservice distributors who employ over 250,000 people. These member companies, both large and small, supply grocery products and provide a wide array of services to retail grocery stores, hospitals, schools, restaurants, and other foodservice establishments throughout the Untied States.

Marketing products from over 700 separate distribution centers, NAWGA member firms account for nearly $50 billion of the nation's grocery product volume and one-third of the grocery supplies distributed nationally. NAWGA's foodservice division, the International Foodservice Distributors' Association (IFDA), represents member firms that sell annually over $10 billion in food and related products to the institutional, away-from-home foodservice market.

NAWGA and its members have a long-standing commitment to our representative form of government and the free enterprise system. We have listed below issues of importance to the wholesale grocery industry, which we believe may be considered during the 99th Congress.

TAX SIMPLIFICATION -

NAWGA commends the Administration for attempting to overhaul its recently submitted proposal. We also commend the Administration for its honest effort to bring tax equity across many industries by removing the Accelerated Costs Recovery System (ACRS) and reducing the corporate tax rate by 13 points.

However, as this Committee is so well aware, small businesses have benefited significantly from the graduated corporate rate schedule which originated in this Committee and became law in 1978. We at NAWGA feel it is critically important that if we in fact reduce the corporate rate as proposed, some form of graduation must be retained for those small businesses who are not at the 33% rate, and therefore, do not benefit from the reduction in the top rate.

CORPORATE SURTAX -

As Congress searches for ways to reduce the federal deficit, a corporate surtax may be advanced as a way of raising revenue.

Whether the surtax is temporary or permanent, it will have important macroeconomic implications. A surtax might be helpful if the economy was experiencing an unsustainable boom. But, if imposed under current economic conditions, might actually slow-down the recovery too rapidly, thus, providing the seeds for a longer and deeper recession.

In addition, a corporate surtax would increase marginal tax rates for our industry that presently has an effective tax rate of nearly 40%. This would have an adverse effect on economic incentives and investment behavior necessary to maintain our nation's industrial capacity and improve our distribution network.

Business has already shouldered the greatest share of the additional taxes as a result of TEFRA and the Surface Transportation Act. An immediate revenue increase through a surtax would impose a drag on the private economy in which many industries are still experiencing an economic recession. Though most surtax formulations would impose a levy on firms that are profitable, even these firms have had their profits sharply reduced by the past recession. Many companies are only now just beginning to replenish capital reserves that were so severely depleted only a short time ago. A bigger tax on a smaller profit margin leaves less capital in private hands for financing investment resulting in higher interest rates and higher consumer prices, and thereby triggering renewed inflationary pressures.

A corporate surtax will disproportionately effect companies and industries that already pay high effective tax rates. Since wholesale grocery companies are inventory and labor intensive, they have one of the highest effective tax rates. A corporate surtax is discriminatory and unfair to the food industry, which has the distinction of being the most competitive industry in the world, with after-tax profits of less than 1 percent.

Record Keeping Rules For Automobiles-

Both Houses of Congress have had bills introduced that would amend the record keeping requirements for automobiles used for business purposes contained in the Tax Reform Act of 1984 (Public Law 98-369). NAWGA strongly supports these proposals.

The wholesale grocery business is uniquely different from all other businesses operating at the manufacturing or retail level. Grocery sales are generated primarily through a substantial "sales representative force." NAWGA member companies may have a fleet of cars as small as 30 for smaller foodservice operators and as many as 600 for larger wholesale grocers. NAWGA member companies employ management and sales personnel who require and use company cars to carry-on their business. It is fairly typical that a member company salesperson will drive 30,000 - 50,000 business miles and make as many as 3000 - 4000 business calls annually.

The overall consensus of NAWGA member companies is that the proposed regulations go far beyond the intent of Congress, and create a nightmare of needless paperwork and recordkeeping, and are too complex and vague. The proposed regulations make lawful compliance nearly impossible. The proposed regulations need to be redrafted in practical terms so that compliance is possible.

Multiemployer Pension Plan Reform-

Since the enactment of the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), NAWGA has sought reform of the withdrawal liability assessments in both the Congress and the courts. These withdrawal assessments are harsh and often exceed a withdrawing employer's total net worth. This is a major concern to NAWGA members, of which 50 percent participate in multiemployer plans, and an important consideration in their business decisions. As a general matter, NAWGA member firms have indicated that the potential assessment of massive, unbudgeted withdrawal liability--which may bear little, if any, relation to a company's assets or to what a company agreed to in their collective bargaining contract--may eventually prevent the sale or dispostion of their business. Essentially a lifetime of hard work and success would be wasted.

We do acknowledge that withdrawal laibility in some form is a necessary deterrent to employers wishing to leave multiemployer plans. However, NAWGA seeks to maintain that deterrent in a way that would strengthen the pension insurance system and provide employers with needed economic flexibility. NAWGA believes that the most fundamental solution to the multiemployer pension plan problem is better funding. We feel adequate funding should be a prerequisite to the granting of any past service benefit increases or past service credit. Future increases would be limited to only plans that are "substantually well-funded."

NAWGA supports a system-wide, comprehensive structural approach and not a narrowly focused, single-industry solution to a situation that plagues all businesses. In this way, NAWGA would hope to strengthen the national insurance system, enhance the economic freedom of the business community, and insure employees of future soundness of their pension program.

Food Stamp Redemption Act-

NAWGA supported legislation has been introduced by Senator David Durenberger (R-MN) which would prohibit banks from charging a processing fee for the redemption of food stamps.

Financial institutions throughout the country have begun a policy of charging retailers service fees for processing food stamp coupons. These fees are not uniform and range from $1.50 per bundle to 8 cents per coupon. Also, they are in addition to the labor and administrative costs incurred when food retailers participate in the food stamp program.

NAWGA has been actively seeking a remedy to this situation since 1983. Our wholesale member companies are concerned that their retail customers are being unfairly penalized by bank charges for the redemption of food stamps. In addition, many of our members operate retail facilities. It is our view that banks must be required to pay retailers the face value of food stamps and without any additional fees. If this situation continues, the viability of the food stamp program is in danger. When retailers who operate on a 1% after-tax profit margin are forced to pay a handling charge of 2 to 6 cents per coupon and the law dictates the retailer may not pass on these costs, many small business retailers will be forced to withdraw from the program. In such a competitive industry, the big chains will survive at the expense of the small, independent grocer.

Preemption Of State Motor Carrier Laws-

NAWGA member firms maintain transportation operations which are largely incidental to their grocery and foodservice business. All NAWGA member firms maintain extensive private carrier operations. On any given day, NAWGA member companies have over 1000 trucks on the road delivering groceries to independent retailers. Many of the laudable transportation goals contained in the Motor Carrier Act of 1980 are ignored at the state level. This is due to a conflicting pathwork of state laws. The net effect of the conflicting and often times burdensome state laws is that motor carriers are unable to fully exercise the productivity options embodied in the Motor Carrier Act and recent ICC decisions. Thus, despite significant federal initiatives designed to improve the motor carrier industry, NAWGA member firms and other motor carriers face substantial barriers on the state level with respect to exercising similar initiatives. For example, NAWGA member firms have encountered substantial state barriers with respect to conducting Compensated Intercorporate Hauling operations (transportation between a parent and its wholly-owned subsidiary), hauling exempt agricultural commodities, obtaining supplemental intrastate common or contract carrier authority, participating in trip leasing and single source leasing arrangements, to name but a few.

The motor carrier industry should not be neatly divided into two functionally independent segments--an interstate segment and an intrastate segment. NAWGA submits that the health of the industry as a whole depends on the degree and type of state and federal regulations. This is not only beneficial to our nation's distribution network, but, to all small businesses that deliver goods to the American consumer.

Dairy Bill

In 1983 the Congress authorized a dairy diversion program in the Dairy and Tobacco Adjustment Act of 1983. This was to be a temporary program with a termination date of March 31, 1985. The program was designed to give dairy farmers an opportunity to thin herds and cut production thereby limiting amounts of product bought by the government. However, legislation has been introduced that would extend the dairy program.

Paying dairy farmers not to produce milk is not the answer to the nations dairy surplus problem. Reducing price supports and stabilizing prices so that consumption increases is a step in the right direction. However, government supplies should not be allowed to reach levels that result in government giveaway programs that displace regular commercial sales.

NAWGA opposes any efforts to extend legislation of this type and is working diligently to defeat it.

National Independent Retail Grocers Week-

Legislation has been introduced in the House, H.J. Res 74, by Congressman Carroll Campbell (R-SC) and in the Senate by Senator Rudy Boschwitz (R-MN), S.J. Res 28, proclaiming the week of September 8, 1985 as National independent Retail Grocers' Week on behalf of NAWGA.

NAWGA members are the primary suppliers for the independent retail grocer in the United States. We are proud to sponsor this effort to honor what we consider to be the economic backbone of the food distribution industry.

Independent retail grocers account for 64% of all grocery stores in the United States and are responsible for nearly one-third of all grocery products distributed. They provide employment for nearly 1 million people. The independent retail grocery store knows no geographical or socioeconomic boundaries with locations as diverse as Beverly Hills, California, Plymouth, Minnesota, and Columbia, South Carolina.

The independent retail grocer exemplifies the small business entrepreneur, the heart and soul of the American free enterprise system. Usually operating fewer than 3 stores, independent grocers tailor their business to serve the community where they are located. Independent retail grocers deliver the highest quality product at the least expense--unsurpassed by any other food distribution network in the world. We are hopeful that this legislation will be acted on shortly by the full Senate and that Members of this Committee will be co-sponsors.

These are some of our legislative concerns for the next Congress and on behalf of the National-American Wholesale Grocers' Association, I thank this body for the opportunity to present this written testimony.

Touche Ross & Co.

PREPARED STATEMENT OF

Robert W. Santy
Director, Small Business Affairs
Touche Ross & Co.
Washington Service Center

before the

UNITED STATES SENATE
COMMITTEE ON SMALL BUSINESS

February 6, 1985

Mr. Chairman and members of the committee, I appreciate the opportunity to submit this statement to you today discussing some of the issues of importance to small business. As many of you know, I recently left the Small Business Administration where I served as Assistant Administrator for Congressional Affairs and later as Chief of Staff. Prior to my three years at SBA I served on the staff of this committee as a professional staff member.

In December I joined Touche Ross as Director of Small Business Affairs in the Washington Service Center. Let me spend just a minute or two describing some of Touche Ross' private and emerging business services and activities. Touche Ross is an international accounting and consulting firm with over 400 offices worldwide and almost 90 in the United States. Dispite the popular view of "big 8" accounting firms, our client base consists of mostly private and emerging businesses. By establishing the Enterprise Group within the firm, Touche Ross is commiting considerable resources to providing comprehensive professional services to smaller clients.

In Washington, we will be using our resources to provide background information and research on small business policy issues. Recently, as many of you know, we released a survey of Members of Congress on small business issues. A copy is attached to my prepared statement. This survey may be helpful to the Committee in defining areas of inquiry for the 99th Congress.

The issue which is clearly receiving the most attention at the beginning of the 99th Congress is the future of the Small Business Administration. The Reagan Administration budget proposes elimination of the SBA in fiscal year 1986. I think it is significant that when asked "do you think the SBA is of real assistance to small business owners" 78% of your colleagues said "yes". Respondents to the survey also ranked SBA as the government agency or body that has done the most to assist small business.

As the debate over the SBA progresses it will become apparent that, consistent with credit policies adopted by this Administration in 1981, the desire is to eliminate SBA's lending functions.

However, this too seems to be contrary to the feelings of Congressional respondents to the Touche Ross survey. When asked "in what areas can SBA be more effective" the number one answer was "lending."

This Committee since 1981 has conducted extensive hearings on the broad range of SBA programs. These hearings have resulted in important new legislation in the areas of procurement, innovation and guaranteed loan secondary market improvements, just to mention a few. Tremendous progress has been made in how SBA addresses the needs of smaller bussinesses through these efforts. Anticipating that the Congress will decide to retain the SBA early in the 99th Congress, I believe the Committee's oversight activities can be critical to the Agency's continued improved performance.

I mentioned procurement legislation as one of the areas where this Committee was particularly active in the 98th Congress. In addition to the Small Business and Federal Procurement Competition Enhancement Act (P.L. 98-577) initiated by the Chairman and other Committee Members, the 98th Congress also saw enactment of the Competition in Contracting Act (P.L. 98-369) and the Defense Authorization Act (P.L. 98-525) all designed to increase competition in the procurement process. Taken together, these laws make sweeping and comprehensive changes in how business does business with the government. I recently was an instructor for a course on the new competitive environment in government contracting to classes consisting of a mix of large and small businesses and government officials. There is tremendous interest about what changes have been made and how business can benefit from the new competitive environment. There is also concern about who retains rights in data on products and services sold to the government and whether the new legislation places an administrative burden on contracting personnel which may be overwhelming.

The legislation also creates new advocacy positions: The Competition Advocates and Break-Out Procurement Center Representatives whose job it is to insure the Congressional intent concerning competition is carried out by the Executive branch agencies.

Without question procurement will continue to be a high priority area for small business as experience is gained under the new statutory provisions.

As a firm, Touche Ross is devoting a considerable amount of time and resources to evaluating a number of tax measures passed by the 98th Congress or being proposed for the 99th.

Perhaps the most widely criticized of the fringe benefit rules included in the 1984 tax legislation is taxation of personal use of company-owned cars.

This was a benefit that many employees previously did not include in their income. Both employers and employees face many nettlesome questions about how to tax personal use of an employer provided vehicle.

The various proposals for a modified flat tax hold out the popular prospect of tax simplification. However, built into the tax code are incentives designed to accomplish agreed upon public policy goals, especially in the areas of savings and investment. Questions which are fairly raised examine how such a tax will effect the level and type of investment. This is of critical concern to small business.

Reduction in capital gains tax rates in 1981 is widely credited with the tremendous growth in venture capital funds. If in fact the differential between capital gains and ordinary income tax rates is removed, will this dry up the pool of venture capital? Additionally, the Treasury Department proposal expands the base upon which the corporate tax will be calculated as well establishing one corporate rate of 33%. This will mean an increase in taxes paid for many smaller businesses. Close scrutiny of these issues is called for. Your Committee has always taken the lead in insuring that the Finance Committee knows the sometimes differential impact of many tax proposals on smaller businesses.

This clearly is not an exhaustive list of issues which the Committee should or will consider during the 99th Congress. However, I believe that SBA, procurement and taxation will be the key issues for small business. I hope you will let me know if Touche Ross and Co. can assist the Committee in its deliberations on these and other issues.

Touche Ross

THE TOUCHE ROSS SURVEY

ON THE FUTURE OF SMALL BUSINESS ENTERPRISE IN AMERICA

An opinion study based on questionnaires completed
by members of the U.S. Senate and the
U.S. House of Representatives.

Conducted by
The Enterprise Group of Touche Ross

January 1985

The Enterprise Group of Touche Ross provides comprehensive professional financial services to private and emerging companies. Its members have the distinctive skills, knowledge, and experience to serve small business and to address specific industry problems and issues. As part of Touche Ross, the international accounting and consulting firm, The Enterprise Group draws upon the full range of resources and expertise of the entire firm to meet the needs of growing businesses.

The Enterprise Group has conducted this survey of the Congress in its continuing effort to provide innovative specialized services to small business.

PREAMBLE

At the end of 1984, Touche Ross surveyed Congressional views on small business, on economic and legislative issues affecting small business, and on the economy overall. Completed written questionnaires were received from 83 members of the Senate and House, or 16 percent of the members of Congress. The respondents represent 28 percent of the Senate and 13 percent of the House, and are divided on party lines in proportion with their representation in Congress. The majority are senior members. Nearly 2/3 describe themselves as having been involved in small business at some point in their careers, 88 percent of those as owners.

Congress believes that small business plays a vital role in the economy. And they express confidence in the future of small business. However, their opinions reflect substantial concern about the nation's economic future. Specifically:

☐ Almost half the respondents foresee a major recession in the near future.

☐ Recent legislation has benefited big business more than small business.

☐ Tax legislation has been the most detrimental to small business.

☐ Congress favors protection for small business from certain forms of foreign competition, but does not support a bail-out fund.

☐ The Small Business Administration is of real assistance and was rated the most responsive of government bodies. The IRS was rated least helpful.

☐ Congress identified high technology as the fastest growing industry and among the most important to the economy, but is not inclined to protect it.

ANALYSIS

Congress unanimously recognizes the importance of small business to the nation's overall economy: 80 percent of the respondents say it is critically important. They acknowledge in particular the contribution of small business to employment: 96 percent of the respondents believe that most new "net" employment comes from the small business area. In terms of support, Congress rates itself second only to the SBA in assistance to small business. However, well over one-half of the respondents (62 percent) believe that recent legislation has helped big business more than small.

Congress considers recent tax legislation as having had the most negative impact on small business. They rated it by 2 to 1 over the next most detrimental, import/export legislation. While the respondents recognize that changes in business and individual tax structure are very important to continued economic recovery, their responses do not reflect a concensus of opinion about a solution.

Congress perceives a direct link between the success of small business and the strength of the national economy. Ninety-three percent of the respondents believe that small business benefits considerably from the current gains in the economy. A significant majority (88 percent) see no trouble in the small business future. At the same time, almost one-half express skepticism about continued economic recovery: 49 percent do not think it will last more than a year. More dramatically, 46 percent anticipate a major recession in the near future, and of those, 57 percent expect it within the coming year.

Consistent with the view that the future of small business is not troubled, a slight majority of the respondents foresee a decrease in small business failures. A strong majority (83 percent) do not support a bailout fund. On the other hand, 62 percent do believe that small businesses should be protected from certain forms of foreign competition.

Respondents recommended protection most strongly for clothing manufacturing and automotive products. Of non-service industries, high technology received least support for protection from foreign competition.

Over three-quarters of the respondents think that the SBA is of real assistance to small business owners. In fact, Congress believes that the agency has done more than any other government body, including itself, to help small business enterprise. The SBA could increase its effectiveness still further by concentrating on lending and procurement. Conversely, Congress believes that the IRS and the SEC have done the least for small business. Among non-government groups, Congress perceives trade associations as most helpful.

Economic Policy

The survey reflects divided opinion on the benefit of "supply side" economics to small business. In total, fewer than half (48 percent) of the respondents believe that small business has benefited from it. Opinion divides along political lines. On the Republican side, 97 percent find supply side economics beneficial, while 87 percent of the Democrats find it without benefit to small business.

Business Failures

Most respondents (56 percent) expect a decrease in the number of small business failures for 1985. However, 56 percent of the respondents from both the East and Midwest expect more business failures in their respective regions than nationwide, while 50 percent in both the North and West expect fewer than nationwide.

Unemployment

Just over half (51 percent) of the respondents expect the unemployment rate to remain approximately the same or to drop. Some optimistic respondents (19 percent) expect the unemployment rate to drop to between 5% and 6%, while 14 percent expect 9% or higher unemployment by September 1985.

Interest Rates

Eighty-five percent of the respondents expect the prime interest rate to be between 10 percent and 15 percent by the end of 1985. Of those who responded after November 1, 1984, when the prime rate was 12%, 50 percent expected the prime rate to be between 10% and 12%, and 37 percent expected it to be between 13% and 15%. This suggests a growing belief in lower interest rates in the future.

Competition

Acknowledging demographic and industry shifts, 92 percent of the respondents believe either the South (50 percent) or the West (42 percent) are the best areas of the country for small business.

Economic Legislation

Respondents see changes in the business and individual tax structure as the most important actions to spur the economy. A close third is the easing of regulation and reporting requirements. Actions such as reducing worker compensation costs, availability of low cost financing, and easing environmental standards, though somewhat important for recovery, are not considered important actions by many respondents.

Deficit Reduction

To aid in deficit reduction, the limiting of federal spending was clearly the respondents' first choice. The adoption of a balanced budget amendment also received substantial support. The use of a line item veto and waste reduction, which received equal support, were well behind the first and second choices.

Effect of Legislation

The passage of procurement legislation was ranked first in importance for aiding small business, with deregulation a close second. Tax laws were rated by a 2-to-1 margin the most negative legislation affecting small business.

RESPONDENTS' PROFILE

The survey had 83 respondents representing 16 percent of the Congress. There were 55 responses from the House of Representatives. The House response represents 66 percent of the total responses and 13 percent of the House members. The Senate had 28 responses representing 34 percent of the entire responses and 28 percent of the Senate members.

The respondents represent a cross-section of the country. The largest group of respondents indicated a constituency in the West (29 percent) or Midwest (26 percent) followed by the South (20 percent), East (16 percent), and the North (9 percent).

The indicated political affiliation was 59 percent Democrat and 41 percent Republican. The political party division of the respondents is in proportion to their current representation in the Congress.

The respondents are senior members of Congress. The majority (54 percent) have served three or more terms; only 32 percent have been in Congress one term and 14 percent for two terms.

The occupational history of 65 percent of the respondents includes experience in small business, primarily (88 percent) as an owner.

SURVEY RESULTS

1 How important is small business to the nation's overall economy?

80%	Critical
20%	Highly Important
____	Not Very Important

2 The nation's economy continues to gain. Will small business benefit:

43%	Greatly
50%	Reasonably Well
7%	Not So Well
____	Not At All

3 Which three business areas are the most important in the development of the country's overall economic well-being? Rate in order of importance.

#1	Manufacturing
#2	Hi Tech
#4	Financial Services
#8	Transportation
#3	Energy
#7	Health Care
#5	Retail
#6	Food

4 How important are the following steps that the government might take to spur economic recovery?

	Very Important	Somewhat Important	Not Important
A. Changes in business tax structure	51%	49%	____
B. changes in individual tax structure	49%	46%	5%
C. Further changes to reduce costs related to workers' compensation	13%	60%	27%
D. Increased availability of low-cost government financing	18%	45%	37%
E. Easing of regulation and reporting requirements	44%	50%	6%
F. Easing of environmental standards	5%	48%	47%
G. Other ____	____	____	____

5 Has the President's "supply side" economic philosophy benefited small business?

48% Yes 52% No

6 How long do you think the economic recovery will continue?

33%	Less Than A Year
16%	One Year
42%	12 to 36 Months
9%	Longer Than 36 Months

7 Which deficit reduction measures do you favor? Rate in order of importance.

#2	Balanced Budget Amendment
#1	Limited Federal Spending (to a percentage of GNP)
#4	Line Item Veto Amendment
#3	Waste Reduction
____	Other ____

8 Has legislation during the past few years helped big business more than small business?

62% Yes 38% No

9 What areas of legislation have helped small business most? Rate in order of importance.

#3	Taxation
#2	Deregulation

#1 Procurement
#4 Import/Export
____ Other ____

10 **What areas of legislation have hindered small business most? Rate in order of importance.**

#1 Taxation
#3 Deregulation
#4 Procurement
#2 Import/Export
____ Other ____

11 **Which new tax legislation, if any, would you support?**

18% No tax for new businesses for the first three years (when earnings are less than $100,000)
38% Graduated tax rate until earnings exceed $50,000
37% Tax credit for hiring additional personnel
7% Other ____

12 **Do you think the SBA is of real assistance to small business owners?**

78% Yes 22% No

13 **In what areas can the SBA be more effective? Rate in order of importance.**

#1 Lending
#2 Procurement
#4 Communication
#3 Training
#5 Advocacy Programs
____ Other ____

14 **Which three government agencies or bodies have done the most to assist small business enterprise? Rate in order of importance.**

#2 The Congress
____ IRS
____ SEC
____ FTC
____ FDA
____ FCC
#1 SBA
#3 Department of Commerce
____ Other ____

15 **Which three organizations have done the least to assist small business? Rate in order of importance.**

____ The Congress
#1 IRS
#2 SEC
#4 FTC
____ FDA
#3 FCC
____ SBA
____ Department of Commerce
____ Other ____

16 **In your opinion, who has been most helpful to small businesses? Rank in order of importance.**

#2 Financial Institutions
#3 Accountants
#4 Lawyers
#1 Trade Associations
____ Other ____

17 **Do you foresee a decrease in the number of small business failures during the next year?**

56% Yes 44% No

18 **How do you think the number of small business failures in your state will compare with small business failures nationwide during the next year?**

39% More Than Nationwide
25% Same As Nationwide
36% Less Than Nationwide

19 **Which five of the following industries will show the greatest growth in the next three years (1984–1986)? Mark only five.**

____ Construction
____ Manufacturing (auto-related)
____ Manufacturing (nonauto-related)
____ Retail
#4 Finance
#5 Health Care
____ Insurance
____ Real Estate
#2 Service
#1 High Technology
#3 Computer Services
____ Food
____ Other ____________

20 **One year from now, the prime rate will be:**

5% 6 to 9 percent
42% 10 to 12 percent
43% 13 to 15 percent
7% 16 to 20 percent
3% Over 20 percent

21 **Do you believe that most new "net" employment comes from the small business area?**

96% Yes 4% No

22 **What do you expect the unemployment rate to be by September 1985?**

19% 5 to 6 percent
32% 7 to 8 percent
35% 8 to 9 percent
8% 9 to 10 percent
6% Higher

23 **What part of the nation do you think is the fastest growing for small business?**

4% North
4% East
50% South
42% West
____ Midwest

24 **Do you foresee any major recession in the near future?**

46% Yes 54% No

25 **If yes, when?**

57% A year from now
35% Two years from now
8% Three years from now

26 **Do you think small businesses should be protected from certain forms of foreign competition?**

62% Yes 38% No

27 **What kinds of industries should be protected?**

31% Clothing Manufacturing
15% Metal Working
11% Hi Tech
6% Health Care or Medical
26% Automotive Products
11% Other ____________

28 **Should there be a bail-out fund mechanism for small business?**

17% Yes 83% No

29 **Is the future of small business in trouble?**

12% Yes 88% No

30 **Have you ever been involved as a "small businessman" in your career?**

65% Yes 35% No

31 **In what capacity?**

88% Owner
6% Employee
6% Consultant

32 **Are you a:**

41% Republican
59% Democrat

33 **What part of the country is your constituency?**

9% North
16% East
20% South
29% West
26% Midwest

34 **Are you a member**

67% House of Representatives
33% Senate

35 **How long have you been in Congress?**

32% One Term
14% Two Terms
21% Three Terms
33% More

STATEMENT OF
MACHINERY DEALERS NATIONAL ASSOCIATION
BEFORE THE
U.S. SENATE COMMITTEE ON SMALL BUSINESS
FEBRUARY 6, 1985

Machinery Dealers National Association (MDNA) is submitting this statement on behalf of its 500 MDNA member firms, all of which are small businesses that account for over 70% of the used machine tools sold in the United States. Because used capital equipment is acquired from large manufacturers and usually resold to small manufacturers, MDNA members are in the unique position to articulate the economic problems of the small business community, which needs your help now. Our statement concentrates on two primary concerns of our members and which we believe are shared by all small businesses: removal of the arbitrary and discriminatory ceiling imposed on the investment tax credit available to purchasers of used equipment and machinery and the need for a national product liability law.

INVESTMENT TAX CREDIT FOR USED MACHINERY AND EQUIPMENT

Under present law, there is a $125,000 limitation on the amounts of used equipment eligible for the investment tax credit, but there is no limitation on the investment tax credit available for new equipment. (This ceiling was to increase to $150,000 in 1985, but due to a freeze established by the "Deficit Reduction Act of 1984," this increase will not occur until 1987.) Similarly, the same carryback/carryforward provisions available for new equipment are not allowed to purchasers of used equipment who may not carryforward or carryback tax credits on investment over the limitation amount.

Since the original $5C,000 ceiling was established in 1962, the cost of basic, unsophisticated used equipment has generally increased by over 500%. It would cost over $600,000 to start a small machine shop which would employ ten people. If a large company which could afford to by new equipment purchased $600,000 of equipment, it would receive an investment tax credit of $60,000 (10% of $600,000). If a small firm bought $600,000 of used equipment, it would receive an investment tax credit of $12,500 (10% of $125,000). In addition, purchasers of new equipment can carryback three years and forward seven years that part of the investment tax credit on the $600,000 purchase which cannot be used in the year of purchase. The small business which purchases used equipment can carryback and carryforward only the $12,500 which is allowed as a result of the limitation. The $475,000 in excess of the limit would receive no investment tax credit in any year. This example clearly illustrates the discriminatory impact on small business of this limitation.

Furthermore, an established manufacturer has hardly begun to retool before he realizes that the $125,000 ceiling offers him very little assistance at all. The original arbitrary and inadequate limit of $50,000 was merely a token gesture to small business and in light of inflation, doubling the limit to $100,000 thirteen years later and to $125,000 nineteen years later has perpetuated the injustice.

This discriminatory tax treatment impacts directly and primarily upon small businesses which are already hindered by their inability to externally or internally generate the capital necessary to buy equipment. Capital stock formation among small business (which may be the nation's best source of economic growth) has been impeded by high interest rates, restricted availability of credit, the government's regulatory burdens, and tax laws which discriminate against small business. Since small business cannot generally afford or justify new machinery, it requires quick passage of tax incentives which will enable it to buy the used equipment it needs for start-ups or to boost productivity and expand the capacity of its current business.

The Joint Economic Committee and the White House Conference on Small Business both have recognized the disparity between large and small businesses as they are affected by inflation and current tax policy. Both have called for tax measures targeted to small business that will enable smaller firms to retain a greater proportion of their earnings for reinvestment in capital improvements and plant expansion.

The current disparity between the investment tax credit available to new and used equipment is in effect a Congressionally mandated discrimination against small business which directly dilutes the ability of small business to compete with large firms and survive. This disparity also allows new foreign machinery a competitive edge through the investment tax credit advantage over equally efficient and price competitive used domestic machinery. We assume this was not the original intent of the $50,000, $100,000, and $125,000 ceilings.

In the 97th Congress, both the Senate and the House Small Business Committee identified the tax credit for used equipment as one of the top priorities in their capital formation and tax recommendations. When introducing his proposal to raise the current arbitrary limitation (S. 360), Senate Small Business Committee Chairman, Lowell Weicker, stated that "the substantial small business dependence on used equipment, particularly in this high technology environment, suggests that as a matter of simple equity for our Nation's small businesses the existing ceiling on used investment should be increased, if not removed entirely." (Emphasis added) Senator Weicker's bill would have raised the ceiling from $100,000 to $250,000. He also urged the Finance Committee to phase in an elevation of the ceiling to reach $500,000 by 1985. Senator Weicker concluded that "elementary justice" and the "improved productivity of our economy" required this basic change.

The importance of this issue is further evidenced by the fact that eight legislative proposals in the House and two in the Senate had been introduced in the 97th

Congress, including Senator Weicker's bill. Senator Bentsen introduced S. 1140 which was cosponsored by Senators Danforth, Baucus, Mitchell, and Chafee. That bill would have raised the limitation to $250,000 and allow a carryback and carryforward of the cost of used equipment if it exceeds $300,000 for any taxable year. Senator Bentsen stated that he believed "that an increase in the regular investment tax credit for used equipment is necessary to assure that the small businesses participate in the general upgrading of productive facilities which this proposal is intended to stimulate.... Finally, by allowing a carryover of any unused tax credit, we insure that businesses make the necessary investment this year without being deterred from making such investments due to the limitation on the amount of property qualifying for the investment tax credit." Senator Bentsen continues to be concerned about this issue. In the 98th Congress, he introduced a small business tax bill, S. 1840, that would have removed the limitation entirely.

In the House, Congressman Bill Frenzel and Congressman Kent Hance had introduced H.R. 1377 and H.R. 3759, respectively, both of which eliminate the limitation entirely. Congressman Tom Downey introduced H.R. 3644 which would have raised the limitation to $300,000 and allowed a carryback/carryforward of the cost of used equipment in excess of that limitation for any taxable year. Congressmen Jimmy Quillan, Dan Marriott, Marty Russo, and Cecil Heftel introduced bills which raise the limitation to $500,000, $300,000, and $200,000, respectively.

We appreciate the efforts of these Senators and Congressmen in attempting to help on this issue. We are concerned that the mere raising of the limitation perpetuates the discrimination which is inherent in the current provisions of the tax code. The carryback three years and the carryforward seven years of the amount in excess of the limitation which was included in a number of these bills would have helped ameliorate this discrimination against small businesses.

In 1975 the Senate Finance Committee reported out and the Senate passed a tax bill which would have eliminated the limitation entirely. In 1981, the Senate Finance Committee reported out a tax bill which eliminated the limitation and required a recapture of the tax credit computed upon the resale value of the used equipment. On the Senate floor this provision was dropped from the bill and Senators Weicker and Durenberger succeeded in the passage of an amendment which raised the ceiling to $125,000 in 1982 and $150,000 in 1985. As indicated above, the increase to $150,000 was postponed until 1987 by the "Deficit Reduction Act of 1984."

Our proposal for small business relief from the discriminatory limitation on the investment tax credit for used equipment and machinery has been supported by the Small Business Legislative Council (see Appendix A), the National Federation of Independent Businesses, the National Association of Wholesaler Distributors, the National Small Business Association, as well as many other small business trade associations. In a poll conducted by the House Small Business Committee, this issue ranked in the top three of all small business tax priorities.

We commend the Senate Small Business Committee for its support of our proposal in the past and urge that it give priority to passage of tax legislation which will eliminate the limitation during the 99th Congress. The benefits to our economy which can be derived from removal of this provision are: more competitive small businesses, stimulation of capital investment, development of creative and innovative products and processes, starting new businesses, helping small business maintain its market share and survive, expansion of capacity and productivity, increased employment, improved balance of payments, increased demand for new domestic machine tools, reduction in inflation, generation of more tax revenues, and equal opportunity for growth of all businesses.

We believe that small business is crucial to the survival of a free enterprise system. Small business is an effective force even in heavily concentrated markets, but its position is frought with difficulties. The tax laws should not further handicap small businesses by giving tax breaks to industrial giants and denying such incentives to small businesses. We urge that enactment of this proposal not only for the major assistance it will give small business in its capital formation efforts but also because of the symbolic importance of the Senate going on record against discriminatory tax treatment of small business.

PRODUCT LIABILITY

MDNA supports the passage of S. 100, "The Product Liability Act," which was introduced by Senator Robert Kasten on January 3, 1985 and which establishes a uniform Federal product liability law. We urge that the members of this Committee cosponsor S. 100 and that this Committee as a body support its passage. S. 100 is almost identical to S. 2631 and S. 44 which were approved by the Committee on Commerce, Science and Transportation in the 97th and 98th Congresses, respectively.

The Product Liability Alliance (TPLA), a diverse coalition of over 230 organizations, including manufacturers, wholesaler-distributors, retailers, insurance companies, agents, and brokers, has been working actively in support of this legislation as well as the Special Committee for Workplace Product Liability Reform of which MDNA is a member. A listing of the TPLA Steering Committee is attached for your information as Appendix B. We are particularly concerned with the product liability problem in the workplace and will concentrate our testimony in that area.

We believe that the facts which have been developed by the Interagency Task Force on Product Liability, the Congressional hearings on product liability, and the studies and surveys conducted by other organizations (including our own members) clearly establish that the product liability problem in the workplace has reached proportions threatening to the industries of America. We agree with Senator Kasten's statement that "product liability legislation is needed to bring uniformity and certainty to the law and to stabilize what has become a serious burden on interstate commerce."

We commend Senator Kasten and the Consumer Subcommittee for preparing a comprehensive and precise product liability law. The developmental process this legislation went through during the 97th and 98th Congresses was comprehensive and balanced. The Consumer Subcommittee recorded and considered thousands of pages of testimony and comments from consumer groups and product sellers, as well as others affected by the product liability system. Legislation was only introduced after a lengthy consultative process which saw the development of four Staff Working Drafts over a period of many months. We believe that S. 100 will simplify, clarify, and bring uniformity to the present tort law of product liability. It should also help to overcome some of the injustices and inequities which have resulted from the extreme positions taken by the courts of some states. By specifying criteria for determining responsibility and limitations on responsibility, S. 100 should reduce uncertainty and ambiguity in the product liability field.

We believe that the product liability problem as it relates to workplace injuries is interwoven tightly with the inequities and injustices inherent in our current system for compensating victims of workplace injuries. Under present law, almost all state workers' compensation statutes (and/or their court interpretation) bar recovery or indemnification from the employer by a workplace product manufacturer, no matter how negligent the employer may have been in failing properly to guard and maintain that product or in failing to instruct and monitor his employees on how to use it. This inequity is further compounded by the fact that, in many jurisdictions, the employer and/or his workers' compensation insurance carrier obtains a subrogation lien from third party recoveries even though the employer may have caused or contributed to the cause of the employee's injury. The Insurance Services Office (I.S.O.) study reveals that about 56% of workplace product liability bodily injury payments involve cases where the employer may have been negligent. Thus, manufacturers of workplace products are, in effect, paying the entire cost of many industrial accidents, while employer users of the products are completely relieved of financial responsibility despite the fact that they may have been in a better position (or in the *only* position) to prevent the accident from occurring. For example, it is the employer who has control over the equipment, its maintenance, and its use, and it is the employer who makes decisions determining whether potential injuries outweigh the cost of preventive measures. Insulating employers and employees from the effects of their own negligence results in a disincentive for workplace safety. The present system is extremely unfair and wasteful, and the wrong party is paying the bill for this wasteful system.

In a 1976 survey of the National Machine Tool Builders Association, it was found that in only 13% of the workplace product related accidents could a case be made that the accident resulted from some sort of mechanical failure of the machine itself. Many of the machines had been modified one or more times by the employer and/or the person or persons from whom he bought the machine. The study shows that 18% of these machines were poorly maintained by the employer. Sixty-three percent of the time the accident occurred because the employer failed to properly guard the machine. Thirteen percent of the accidents occurred because he failed to make sure that his employees used the appropriate safety device. Sixty-five percent of the injured employees did not receive appropriate training from their employers on how properly and safely to operate the machine. The survey also showed that 56% of the injured employees had been on the job for less than six months prior to the accident. These statistics reveal the variety of causes of workplace injuries, which are beyond the product manufacturer's control and yet, because of the failure to integrate the legal principles and social basis of strict liability and workers' compensation, the manufacturers of workplace products are paying for these injuries while the employee and employer are relieved of any responsibility. The House Subcommittee on Capital, Investment, and Business Opportunities concluded that: "It is inequitable for manufacturers to shoulder the entire burden for workplace injuries when the employer's negligence contributed to the same." H.R. Rep. No. 997, 95th Congress., 2d Sess. 74 (1978).

The high costs involved in having key personnel assist in the defense of a case must also be considered. We cannot understate ths cost to industry of executive and engineering time spent in responding to voluminous discovery requests and in defending product liability suits.

The cost of resolving product liability disputes cannot be overlooked. These high transaction costs are caused largely by the lengthy litigation involving applicable rules of liability, rules that are subject to a great deal of uncertainty. The Product Liability Alliance has cited estimates that for every 66 cents an injured claimant receives, 77 cents is spent in legal costs. The quantity of product liability lawsuits has led many product liability insurers in the late 1970's to either leave the field or to charge high premiums unrelated to the insured's individual claims experience. These high transaction costs cannot be justified as part of any meaningful compensation system.

Unfortunately, in dealing with this crisis, the manufacturers may not in fact even have the option of selling out and ceasing to operate in the field rather than risking bankruptcy, since unfunded contingent liability on claims not yet filed makes it difficult if not impossible to sell small companies in the machinery manufacturing and distribution field, even through a sale of assets. In James Allen Trimper v. Bruno-Sherman Corp., 437 F. Supp. 349 (E.D. Mich. 1977), for example, the court found that liability can attach to a successor to certain assets of the original third party manufacturer of a machine which was involved in an injury, even though there had been two intervening sales of assets of the original company. Fear of being "infected" with potential future claims through any interrelationship, no matter how attenuated, leaves the manufacturer who cannot afford insurance unable even to sell his company or its assets.

The harmful effect of these economic realities upon the capital equipment industry in the United States is hard to estimate exactly; but it clearly has had a major impact on increased prices with an attendant ripple effect on sales, inflation, and ability to compete with foreign sources. The costs are ultimately passed on to U.S. consumers in the form of higher prices for products. Some companies discontinue manufacturing those items that account for most product liability suits and thereby remove highly vulnerable, but possibly vital, industrial products. The Interagency Task Force on Product Liability in its 1978 study also found that some firms are already reluctant to develop and introduce new products because of product liability risk. This trend could exacerbate the already serious problem of the United States losing its competitive edge in technology.

Product sellers, insurers, and risk retention groups need a uniform, unambiguous, and fair product liability law so that they will have a firm basis upon which to project their responsibility and liability exposure. Currently, the "rules vary from jurisdiction to jurisdiction and are subject to rapid and substantial change. These facts militate against predictability of litigation outcome." 44 Fed. Reg. 62716 (1979). The proposed "Product Liability Act", S. 100, addresses this problem where it must be dealt with: at the Federal level. At the same time, however, it calls for no expenditures of Federal revenues, no new Federal bureaucracy, and no expansion of the Federal courts.

There is no single system or common body of laws which exist in the United States concerning product liability. Each state has its own common law on product liability. In recent years this common law has been subject to frequent and substantial revision. Because of the rapid change in product liability law in each state, and because the common law rules on product liability vary from state to state, it is virtually impossible for a manufacturer of products sold throughout this country to determine the current status of "the law" when it is attempting to determine its legal duties. Insurance companies claim that they cannot predict their exposure and that, to avoid disaster, they are forced to assume the worst and charge accordingly. Manufacturers are outraged at increases in deductibles and high premiums which do not reflect actual product risks or liability losses.

There are those who say that current efforts to achieve product liability reform at the state level will resolve this problem. However, that solution ignores the fact that product liability insurance rates are not set on a state-by-state basis, but rather are established on the basis of a nationwide experience. Since the sale of products is not limited to the state in which they are manufactured, and tort law varies from state to state, it is not surprising that the insurance companies set their rates on their nationwide loss projections. Furthermore, there is no indication that tort reform laws that are passed on a state-by-state basis will be sufficiently similar ever to form the basis for the predictability and certainty which are a prerequisite to lowering of insurance rates.

We also recognize that the thousands of small businesses represented by our organization cannot afford the legal and engineering time and cost which would be necessary to analyze the responsibility of a manufacturer under the product liability laws of all 50 states. This has had a chilling effect on product development and innovation. Furthermore, the uncertainty in the law requires extensive and costly litigation in the pursuit of further definition and determination of what legal principles are applicable in a given case. A court must not only decide which state's law will govern the case but it must also then delve into the morass of conflicting decisions concerning the subject. Of course, this is exacerbated by the increasing volume of product liability litigation. Indeed, the number of product liability cases filed in Federal courts around the country has "more than doubled in the last three years." Business Insurance, October 12, 1981.

It is important to note that the tort reform laws which have been passed at the state level are not consistent but differ in substantial degree. In fact, recently enacted state product liability laws have created new variances in our nation's tort laws, resulting in more confusion and uncertainty. Over thirty states have enacted some form of product liability statute in the past six years. Of the states which have passed such legislation, some have passed a statute of repose, cutting off liability on products after a given life span, and others have not. Some of these provide for an absolute cutoff of liability after a number of years (varying from 6 to 12), and others provide for a presumption of no responsibility after a given number of years or something less. While some provide that modification or misuse of a product is a defense, others do not. Some of these statutes are very limited in scope; others are more comprehensive. The language used for similar provisions differs, thereby opening the door for varying judicial interpretation. While we applaud the efforts to achieve tort reform at the state level, we have no confidence that the same bill will be passed in each state with the same provisions or the same language. The current experience with state tort legislation suggests variations will occur even in passage of a model product liability act, followed by further variation in judicial interpretation. Finally, we believe the inequity and imbalance in the current product liability system must be corrected with a minimum of delay. The adverse impact on medium and small business and ultimately upon consumers and the economy in general cannot be allowed to continue much longer. It took 15 years to pass the Uniform Commercial Code at the state level, and it still has variations from state to state. The nation cannot afford to wait 15 years for widespread passage of a model product liability act.

It is argued that we should not have tort reform at the Federal level because tort law has historically been the province of the states. We believe recent legislative history indicates that this is not true. There are a number of Federal statutes which were enacted to provide benefits or settle claims where state law was deemed inadequate to compensate for workplace injuries. Perhaps the first Federal legislative effort in this area was the "Federal Employees' Liability Act" which was passed in 1908 in order to apply a Federal tort law to determine the damages incurred by any railroad employee injured or killed in the course of employment. This was followed in 1927 by passage of the "Longshoremen's and Harbor Workers' Compensation Act" which provided workers' compensation as well as a Federal tort law to deal with claims against ship owners. More recently, laws have been enacted which, for example, provide compensation benefits for non-Federal law enforcement officers (5 U.S.C. §§ 8191-8193) and compensation for black lung victims (30 U.S.C. §§ 901-936). Importantly, the tort law called for here, unlike the Longshore and Black Lung schemes, requires no Federal bureaucracy and no expenditure of Federal monies.

Since the late 1960's, there has been an increasing involvement of the Federal government in tort law related issues: "The Crime Control and Safe Streets Act" 18 U.S.C. § 2520 (1968) (civil action against any person who intercepts a telephone conversation); "Consumer Product Safety Act" 15 U.S.C. § 2072 (1972) (Federal tort remedy for persons who are injured as a result of a knowing violation of a safety standard or rule of the CPSC); "Price-Anderson Act" 42 U.S.C. § 2012 (1975) (no-fault compensation system for catastrophic accidents at nuclear power plants); "National

Swine Flu Immunization Program" 42 U.S.C. § 247(b) (1977) (Federal responsibility for strict liability tort claims that arose out of that program). In addition, Federal regulation of airline transportation has changed the law of trespass and nuisance as it regards aircraft. Moreover, the comprehensive "Environmental Response, Compensation and Liability Act of 1980," which deals with the damages that arise from hazardous substances, impacts on traditional state tort law by establishing Federal strict standards of liability, joint and several liability, as well as apportionment of damages. Clearly, there is ample precedent for Federal legislative activity in tort law. The tradition of state control over tort law has long given way where there is a need for national solutions to national problems. The proposed legislation addresses what is certainly one of the most appropriate and sorely needed areas of Federal attention.

Because of the severely detrimental impact on interstate commerce of the current chaos among states regarding product liability, we believe that product liability reform should be enacted at the Federal level and not on a state-by-state basis. Since product liability insurance rates are set on the basis of a nationwide experience rather than individual state experience, variations on a state-by-state basis will impact adversely on the goal of achieving affordable and stable product liability insurance rates. Through a clear understanding of their product responsibilities as set forth in the Federal bill, manufacturers will no longer be reluctant to develop new and innovative products which will be distributed throughout the country. Litigation costs will be substantially reduced through elimination of the costly process of determining conflicts of law issues and defining which principles of law are applicable. We believe that the only way to alleviate these problems is to enact this tort reform legislation on a nationwide basis, thereby insuring uniformity and stability in the law of product liability and hastening the implementation of this much needed reform.

Understanding that the product liability problem in the workplace is a serious impediment to interstate commerce requiring Federal legislation, we believe that the S. 100 is an appropriate response to that problem.

We urge the Senate Small Business Committee to include in its priorities the passage of S. 100 and the elimination of the limitation on the investment tax credit available to purchasers of used machinery and equipment.

APPENDIX A

INVESTMENT TAX CREDIT

The decline in our productivity is caused by several conditions. For the first time in twenty years, the Joint Economic Committee Annual Report of 1979 unanimously concluded that an increase in productivity is vital to the improvement of our economic standard of living and to the reduction of inflation. A partial cause of this situation is the antiquated production facilities of many American manufacturers. Another partial cause is the utilization of inefficient equipment; and yet another partial cause is the overall age of our country's industrial machinery. The most recent U.S. survey of machine tools shows only 11% of the industrial machinery in use today is less than five years old; 76% is at least ten years old. Equipment renewal and upgrading are necessary in both large and small manufacturing companies. Increasing productivity through equipment renewal is best achieved for small business through the purchase of affordable used machinery and equipment.

Under present law there is a $100,000 limitation on the amount of used equipment eligible for investment tax credit, but there is no limitation on the investment credit available for new equipment. This discriminatory tax treatment impacts directly and primarily on small business which is already hindered by its inability to externally or internally generate capital necessary to buy new equipment.

In order to increase productivity and competition, the discriminatory ceiling on the amount of used property eligible for a tax credit must be eliminated; and, the carryover provisions available for new property must also be available for similarly situated used property. Traditionally, small businesses purchase used capital equipment; large businesses basically purchase newly manufactured capital equipment. The cost of obtaining capital for production equipment is high for everyone, especially those who cannot borrow at the prime rate. Firms purchasing used capital equipment do not have a chance to offset some of their costs through this tax credit. Confining the investment credit to only equipment with the latest technology helps primarily the largest enterprises and basically ignores the numerically greater small business segment of our economy which needs this tax credit the most. Because the small business sector offers the greatest potential for increasing employment, there is normally a direct relationship between increased installation of used machinery and increased employment.

RESOLVED

Small Business Legislative Council urges and supports changes in the IRS Code to allow a full investment tax credit for used machinery and equipment. This full investment tax credit will allow small businesses to receive the same tax incentive provided to big businesses and would allow small businesses to compete, to maintain their current market share, and to hopefully expand output and productivity.

The National
Small Business
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Telephone
(202) 296-7400

Small
Business
Legislative
Council®

July 30, 1980

The position paper -- Investment Tax Credit -- is supported, as of this date, by 51 members of the Small Business Legislative Council:

American Assn. of MESBICs
  Washington, DC

American Assn. of Nurserymen
  Washington, DC

American Metal Stamping Assn.
  Richmond Heights, OH

Assn. of Diesel Specialists
  Kansas City, MO

Assn. of Indep. Corrugated Converters
  Washington, DC

Assn. of Physical Fitness Centers
  Bethesda, MD

Automotive Warehouse Distribs. Assn.
  Kansas City, MO

Bldg. Service Contractors Assn. Intl.
  Vienna, VA

Business Advertising Council
  Cincinnati, OH

Christian Booksellers Assn.
  Colorado Springs, CO

Direct Selling Association
  Washington, D.C.

Eastern Manufs. & Importers Exhibit
  New York, NY

Electronic Reps. Assn.
  Chicago, IL

Independent Bakers Assn.
  Washington, DC

Indep. Business Assn. of Michigan
  Kalamazoo, MI

Indep. Sewing Machine Dealers of America
  Hilliard, OH

Intl. Franchise Assn.
  Washington, DC

Local and Short Haul Carriers Natl Conf.
  Washington, DC

Machinery Dealers Natl. Assn.
  Silver Spring, MD

Manufacturers Agents Natl.
  Irvine, CA

APPENDIX B

THE PRODUCT LIABILITY ALLIANCE
1725 K Street, N.W Suite 710
Washington, D.C. 20006
(202) 872-0885

THE PRODUCT LIABILITY ALLIANCE

STEERING COMMITTEE ORGANIZATIONS

Aetna Life & Casualty

A H Robins

Alliance of American Insurers

American Business Conference

American Insurance Association

American Mining Congress

Armco, Inc.

Associated Equipment Distributors

The Black & Decker Manufacturing Company

The Business Roundtable

CIGNA, Inc.

Colt Industries, Inc.

Crum & Forster Insurance Companies

Door & Hardware Institute

E I Dupont de Nemours Company

FMC Corporation

General Electric Company

Gulf & Western Industries, Inc.

Hartford Insurance Group

Household International

Independent Insurance Agents of America

Material Handling Institute

Merck & Company, Inc.

Motor Vehicle Manufacturers Association

National Association of Casualty & Surety

National Association of Furniture Manufacturers

National Association of Manufacturers

National Association of Wholesaler-Distributors

National Electrical Manufacturers Association

National Machine Tool Builders Association

National Product Liability Council

National Rifle Association of America

Oliver Machinery Company

Professional Insurance Agents

Small Business United

Special Committee for Workplace Product Liability Reform

Sporting Goods Manufacturers Association

Textron, Inc.

U. S. Chamber of Commerce

U. S. Industrial Council

3M Company

Marking Device Assn.
Evanston, IL

Menswear Retailers of America
Washington, DC

MN Assn. of Commerce & Industry Small
Business Council, St. Paul, MN

Narrow Fabrics Institute
New Rochelle, NY

Natl. Assn. of Catalog Showroom Merchs.
New York, NY

Natl. Assn. of Floor Covering Distribs.
Chicago, IL

Natl. Assn. of Plastic Fabricators
Washington, DC

Natl. Assn. of Plastics Distribs.
Jaffrey, NH

Natl. Assn. of Retail Druggists
Washington, DC

Natl. Candy Wholesalers Assn.
Washington, DC

Natl. Coffee Service Assn.
Chicago, IL

Natl. Electrical Contractors Assn.
Bethesda, MD

Natl. Family Business Council
West Bloomfield, MI

Natl. Home Improvement Council
New York, NY

Natl. Independent Dairies Assn.
Washington, DC

Natl. Insulation Contractors Assn.
Washington, DC

Natl. Meat Assn.
Washington, DC

Natl. Office Machine Dealers Assn.
Des Plaines, IL

Natl. Paper Box Assn.
Haddonfield, NJ

Natl. Paper Trade Assn.
New York, NY

Natl. Parking Assn.
Washington, DC

Natl. Patent Council
Arlington, VA

Natl. Pest Control Assn.
Vienna, VA

Natl. Small Business Assn.
Washington, DC

Natl. Society of Public Accountants
Washington, DC

Natl. Tire Dealers & Retreaders Assn.
Washington, DC

Natl. Tooling and Machining Assn.
Washington, DC

Natl. Tour Brokers Assn.
Lexington, KY

Power & Comm. Contractors Assn.
Washington, DC

Printing Industries of America
Arlington, VA

Sheet Metal & Air Cond. Contrs.
Natl. Assn., Vienna, VA

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February 4, 1985

Chairman
Committee on Small Business
United States Senate
Room 428A
Russell Senate Office Building
Washington, D.C. 20510

Attn: Ms. Tracy Crowley

Re: Federal Procurement Policy

Dear Mr. Chairman:

We understand that on February 6, 1985, your Committee will hold an informal hearing to consider which small business issues should be given priority during the 99th Congress, 1st Session. Should federal procurement policy as it relates to small business be deemed an area of general priority, we request that your consideration of the matter include specific consideration of the impact of federal procurement policy on competition, not only between "big business" and "small business", but also within the small business community itself.

For example, for a number of years, various interest groups, including large and small businesses, have pushed the concept of "commercial products acquisition" on procuring agencies, primarily GSA and DoD. So long as the policy is to open up competition to all responsible suppliers, we have no objection. However, on occasion, the policy has been expressed such that only commercial suppliers - i.e., those who supply to the general public from inventory at established prices - would be entitled to compete. When the policy is expressed in this manner, contract manufacturers - i.e., those manufacturers who supply quantities to specific purchasers pursuant to specific contract - would simply be excluded from competition. On behalf of our client, Jebco, Inc., a contract manufacturer of metal office furniture located in Warrenton, Georgia, we strongly oppose such policy when it is expressed in terms of thus restricting competition.

Another example is the "multiple awards schedule program", or "MASP", under which certain suppliers periodically negotiate prices directly with the government and thereafter sell directly to procuring agencies. The MASP has the general support of retailers and the manufacturers for whom they sell, for the obvious reason that it benefits those who maintain large inventories. The MASP is typically not supported by contract manufacturers for the simple reason that their method of operation does not involve the maintenance of large inventories on an on-going basis. The discussion of MASP is often phrased as if it were a "small business" versus "big business" issue. It is not. It is really a "retailer" versus "contract manufacturer" issue, and the players on either side may be large or small. For example, Jebco, which is a small business as well as a contract manufacturer, takes the position that the MASP may be quite appropriate for purchase of small quantities over an indefinite period of time, but is quite inappropriate when the government wishes to acquire a large quantity of a specific item. In the latter case, competitive bidding is clearly appropriate.

My primary purpose in writing is simply to advise you for the record that small businesses who are contract manufacturers often take a different view of federal procurement policy than do retailers. We do not seek set asides or special treatment. We believe in full and open competition for all without artificial barriers, and maintain that in the long run this is the best policy for both the government and the private sector.

Should you determine that federal procurement policy will be a Committee priority and that specific areas will be examined, we would appreciate being notified so that we can participate in your deliberations.

Thank you.

Very truly yours,

Troutman, Sanders, Lockerman & Ashmore

By: Stanley H Hackett

Stanley H. Hackett
Attorneys for Jebco, Inc.